

A Guide for Entrepreneurs, Executives,
Directors and Private Investors

THE IPO HANDBOOK

Second Edition

Sonny Allison
Justin Bastian
Eric DeJong
Nora Gibson

Chris Hall
David McShea

AND CONTRIBUTING AUTHORS
FROM PERKINS COIE LLP

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The Initial Public Offering Handbook:

**A Guide for Entrepreneurs, Executives,
Directors and Private Investors**

Second Edition

**Sonny Allison
Justin Bastian
Eric DeJong
Nora Gibson
Chris Hall
David McShea**

with

Contributing Authors from Perkins Coie LLP

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Merrill Corporation
Publications Department
One Merrill Circle
St. Paul, Minnesota 55108
(651) 698-1865

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DEDICATION

We dedicate this book to our partner and colleague Stewart Landefeld for his mentorship and leadership, and for serving as a role model of what it means to be a professional.

About Perkins Coie

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Lead Authors

Sonny Allison regularly counsels public and private companies and private equity funds in corporate transactions, corporate governance matters and securities law compliance matters. He has extensive experience with public and private mergers and acquisitions, leveraged buyouts and recapitalizations, tender offers and going private transactions, asset acquisitions and dispositions, initial public offerings, follow-on offerings, PIPE and 144A transactions and private placements.

Justin Bastian represents private companies, public companies and financial institutional clients in a wide range of equity offerings and debt financings. He has guided clients through more than 100 public offerings in such industry sectors as semiconductors, technology software and hardware, clean technology, REITs, Internet and communications. Justin works with clients on SEC, public reporting and other regulatory compliance issues, and finance.

Eric DeJong has over 25 years' experience providing transactional, governance and securities-related advice to public and private companies in a wide range of industries. He has a broad range of securities offering experience, including initial and follow-on public offerings, debt offerings and PIPE financings and regularly advises public companies on SEC reporting, disclosure and corporate governance matters.

Nora Gibson has lead more than 100 initial and follow-on public offerings, primarily by growth-oriented technology and biotechnology companies. She represents emerging growth companies and investment banks in registered public equity and debt offerings, 144A private placements, private investment in public offering transactions (PIPEs) and mezzanine-level private placements. Her deal portfolio includes major financings across a range of industries, including mining, semiconductors, technology hardware and computing, Internet media, pharmaceuticals and life sciences.

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Chris Hall focuses his practice on serving clients in the areas of corporate finance, mergers and acquisitions and private equity. He manages complex transactions, including public offerings, for mid- market companies, and is adept at handling transactions having strategic importance to a company's future or particularly difficult issues.

David McShea focuses on the representation of high growth technology companies, public companies and venture capital firms. He has handled numerous significant transactions including the initial public offerings of Amazon and Zillow, mergers and acquisitions, public equity and debt financings, startup financings and venture capital financings. David has been selected four times by *Best Lawyers* as "Lawyer of the Year" in Seattle in corporate law areas. He is a frequent speaker on startups, venture capital, IPOs and corporate governance.

Contributing Authors

We gratefully acknowledge the contributions of the following Perkins Coie colleagues:

Danielle Benderly, Portland
David Clarke, Seattle
Nick Ferrer, Seattle
Timothy Fete, Jr., Denver
Allison Handy, Seattle
David Katz, Los Angeles
Sean Knowles, Seattle
Stewart Landefeld, Seattle
David Matheson, Portland
Bobby Majumder, Dallas
Andrew Moore, Seattle
Sarah Rivard, Seattle
Lee Schindler, Seattle
John Thomas, Portland
Roy Tucker, Portland
Faith Wilson, Seattle
Lior Zorea, Palo Alto

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The authors welcome your comments and suggestions via email:

Sonny Allison: SAllison@perkinscoie.com
Justin Bastian: JBastian@perkinscoie.com
Eric DeJong: EDejong@perkinscoie.com
Nora Gibson: NoraGibson@perkinscoie.com
Chris Hall: CHall@perkinscoie.com
David McShea: DMcShea@perkinscoie.com

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Anchorage 1029 W. Third Avenue Suite 300 Anchorage, AK 99501	
Beijing 2 S/F South Tower Beijing Kerry Center 1 Guang Hua Road Chao Yang District Beijing, China 100020	
Bellevue The PSE Building 10885 N.E. Fourth Street Suite 700 Bellevue, WA 98004	
Boise 1111 W. Jefferson Street Suite 500 Boise, ID 83702	
Chicago 131 S. Dearborn Street Suite 1700 Chicago, IL 60603	
Dallas 500 N. Akard Street Suite 3300 Dallas, TX 75201	
Denver 1900 Sixteenth St. Suite 1400 Denver, CO 80202	
Los Angeles 1888 Century Park East Suite 1700 Los Angeles, CA 90067	
Madison 1 East Main Street Suite 201 Madison, WI 53703	
New York 30 Rockefeller Plaza 22nd Floor New York, NY 10112	
Palo Alto 3150 Porter Drive Palo Alto, CA 94304	
Phoenix 2901 N. Central Avenue Suite 2000 Phoenix, AZ 85012	
Portland 1120 N.W. Couch Street Tenth Floor Portland, OR 97209	
San Diego 11988 El Camino Real Suite 350 San Diego, CA 92130	
San Francisco 505 Howard Street Suite 1000 San Francisco, CA 94105	
Seattle 1201 Third Avenue Suite 4900 Seattle, WA 98101	
Shanghai 16F, Hang Seng Bank Tower 1000 Lujiazui Ring Road Pudong New Area Shanghai 200120	
Taipei Taipei 101 Tower Suite F, 45 Floor No. 7, Section 5 Xinyi Road Taipei, Taiwan 11049	
Washington, D.C. 700 Thirteenth Street NW Suite 600 Washington, D.C. 20005	
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Contemplating an IPO: Benefits and Costs of the IPO and Being Public

Introduction

An initial public offering is the realization of a dream for many entrepreneurs, executives, board members and stockholders, a singular achievement that demonstrates their success in building a strong business and creating value for owners, employees and customers. However, an initial public offering is not only a milestone, it is also the entrance into a new stage—life as a public company—that possesses its own unique opportunities, risks and challenges. Some of those opportunities, such as opening a door to liquidity for investors, can be achieved in other ways, such as with a sale or private equity recapitalization of a company. In choosing to pursue an initial public offering, a company’s board and executive officers should analyze the relevant considerations and weigh the advantages and disadvantages carefully in light of the company’s particular circumstances.

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Initial Considerations

An initial public offering requires a great deal of effort, expense and management focus. To execute an IPO, a company must work closely with legal counsel, auditors and underwriters, to identify, analyze and resolve a myriad of legal, accounting and business issues. General considerations that an IPO candidate should evaluate to determine whether it is prepared for an IPO include:

- The company’s profitability and growth prospects and visibility into, and the predictability of, its future financial results;
- The company’s ability to articulate a clear, cohesive strategy and its competitive strengths that support its ability to succeed with its strategy;

- The ability of the management team and board of directors to transition into and succeed as a public company;
- Management’s ability to meet investor relations demands, including the need to articulate the company’s strategy and to build and preserve credibility with analysts, the financial press, regulators, institutional stockholders and other players in the capital markets;
- The ability to articulate the strength of the company’s intellectual property position and key commercial arrangements;
- The company’s competitive position and competitive barriers to entry;
- The status of the public markets generally and market conditions for the particular company’s industry; and
- Legal, accounting and regulatory compliance obligations of public companies, including compliance with U.S. Securities and Exchange Commission (“SEC”) and national securities exchange rules relating to reporting and disclosure obligations, corporate governance, disclosure controls and internal controls over financial reporting.

There are a number of other considerations that a company should evaluate when contemplating an IPO, including whether the company qualifies as an emerging growth company under the Jumpstart Our Business Startups Act, or JOBS Act, restrictions on publicity before and during the offering, selection of underwriters, disclosure of related-party transactions, disclosure of executive compensation, prohibition on loans to directors and officers, structure and composition of the board and board committees, ethics and conduct codes and procedures, accounting and corporate law matters, listing on a stock exchange, and compliance with the SEC registration process.

Costs of an IPO

Going public entails significant costs. These include underwriters’ discount and commissions, fees for the company’s outside legal counsel and independent auditor, printing costs, stock exchange listing fees and SEC filing fees. The legal and accounting costs for different companies will vary widely depending on the amount of corporate cleanup required, the extent to which

the company’s historical financial statements have been previously audited, and the level of complexity of the offering. In the past five years, the aggregate expenses for an offering, excluding underwriters’ discounts and commissions, have approached on average \$4 million, with yearly averages from the low \$3 million range to the low \$4 million range. Outside counsel and independent auditor fees are major components of the overall IPO expense. Legal fees have averaged over \$1.8 million the last several years, with yearly averages ranging from \$1.6 million to \$1.9 million. IPO auditor fees averaged over \$1 million, ranging from approximately \$800,000 to \$1.2 million.

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Costs of Maintaining a Public Company

Life as a public company after the initial public offering also entails significant ongoing expenses. Public companies must comply with the reporting requirements of the Securities Exchange Act of 1934 (the “Exchange Act”), including filing an annual report, quarterly reports, a proxy statement and any necessary current reports. The preparation and filing of these reports often require a company to incur legal and/or accounting fees and in some cases can cause a company to incur printing costs and filing fees. In addition, a public company’s directors, officers and principal stockholders will be required to file reports with the SEC regarding their ownership of, and transactions in, the company’s stock and equity incentives. A public company will also often incur increased costs to maintain adequate financial reporting, compliance and legal staff whose focus is to make sure that the company complies with the legal and regulatory obligations of being a public company.

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), followed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) and the legal and accounting regulations adopted in their wake, have greatly increased the legal, accounting and compliance costs of being a public company. Furthermore, costs may continue to increase due to the adoption of new rules in the future. Estimates on post-IPO compliance costs, including internal costs, vary widely and can range from hundreds of thousands of dollars to upwards of several million dollars per year. In any case, these costs remain a significant burden that any company contemplating an IPO must consider.

We discuss in more detail post-IPO legal compliance requirements in Chapter 11.

Advantages and Disadvantages of Being Public

Advantages

Going public is an attractive alternative for many companies because of the many potential benefits it confers. These include:

- The ability to raise significant outside funding for company growth, hiring of talent, increased marketing, greater research and development and expanded products and services;
- Access to the public capital markets after the IPO, which generally enables a company to raise money more quickly with less cost and more flexibility than it can in the private markets;
- The ability to use the company's stock as "currency" to acquire other companies because sellers are more willing to accept stock with a liquid public trading market than illiquid private company stock;
- Greatly increased liquidity for investors and employees through the creation of a liquid public market and greatly expanded pool of potential purchasers to facilitate sales of stock;
- Expanded opportunity to use of stock options and other equity awards to incentivize, motivate and compensate employees;
- Creation of potential significant wealth for founders and pre-IPO stockholders;
- Increased corporate reputation, stature, visibility and credibility with investors, customers, business partners and current and potential employees; and
- Increased market value for the company, because the illiquidity discount applicable to private company stock has been eliminated.

Disadvantages

Going public is not necessarily a panacea. Becoming a public company has significant disadvantages as well, some of which include:

- Extensive public reporting and disclosure requirements, which invite scrutiny, may effectively reduce management flexibility and may disadvantage the company by providing valuable information to competitors, suppliers, customers and business partners;
- Significant costs associated with the IPO and post-IPO compliance with SEC and stock exchange requirements;
- Pressures on management engendered by reporting quarterly and annual financial results and the short-term bias of Wall Street expectations;
- Increased risk of class-action lawsuits and personal liability for directors and officers and the significant cost of obtaining directors' and officers' liability insurance;
- Distraction of management's attention from the business both during the IPO process and afterward when management must devote substantial time and effort to complying with SEC reporting and to investor relations demands;
- More complex corporate governance structure and regulations and increased demands on the time and attention of directors;
- Dilution of ownership of founders and other current major stockholders, which can reduce their control over company affairs;
- Restrictions on sales by insiders arising under Rule 144 and Rule 10b-5 of the Exchange Act, as well the short-swing trading profit rules of Section 16(b) of the Exchange Act, which require that executive officers and directors "disgorge" profits obtained from the purchase and sale of company stock within a six-month period; and

- The risk of hostile takeover bids, which is increased when the insiders' ownership percentage is decreased by the IPO and large portions of the company's stock can change hands publicly. (This risk can be mitigated by anti-takeover protections, which we discuss in Chapter 3.)

The JOBS Act (which is discussed in greater detail in Chapter 5) has mitigated some of these disadvantages to a degree. Adopted in 2012, the JOBS Act was intended to make the process of going public easier for emerging growth companies ("EGCs") in order to spur job creation and economic growth by improving access to capital for emerging growth companies. EGCs are entitled to confidentially submit an IPO registration statement to the SEC prior to publicly filing it, which allows the EGC to delay disclosure of sensitive information until the EGC is nearly ready to take its offering to market (or avoid disclosure if the IPO does not proceed). Also, the EGC gets the benefit of an "IPO on-ramp," which provides for reduced or "scaled" disclosure requirements for a period of years following the IPO, as well as exemptions from various corporate governance and accounting requirements.

The decision to go public typically engenders a range of emotions for the leaders and owners of a company—from excitement to anxiety and from enthusiasm about the benefits of going public to concern about the burdens it brings. Being well-informed about the process of going public will help the board, management and their advisors channel that excitement and energy into preparation, planning and thoughtful execution—precisely the steps that will ensure a smooth, successful IPO and make the commencement of life as a public company memorable and rewarding.

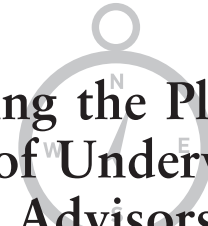
The Statistics

"On the Rebound": Public IPO Filings, Withdrawals and Completions Since the 2008-2009 Recession

Between 2002 and 2007, riding the coattails of a resurgent economy, the IPO market rebounded strongly, with 282 IPOs completed in 2007. In the wake of the "Great Recession" in 2008 and 2009, the IPO market fell precipitously, with only 51 IPOs completed in 2008, and only 64 in 2009. As the economy once again recovered, the IPO market followed suit, exceeding its 2007 mark with 296 IPOs completed in 2014, before declining slightly to 185 IPOs completed in 2015.

If you file for your IPO, what are the odds that you will complete it? If the publicly filed statistics for the years 2008 through 2015 are any indication, nearly 7 in 10. Does that mean that more than 30% of attempted initial public offerings fail? Certainly not. Many IPO filings are abandoned for sound, positive business reasons. For example, a company that has filed for an IPO may receive an acquisition offer that is simply too good to pass up. In that situation, the company will withdraw its IPO filing in connection with completing its sale to a buyer.

Furthermore, the effect of the JOBS Act's confidential submission process, which allows an EGC to confidentially withdraw its confidentially submitted registration statement, may cause the number of companies who contemplate but later abandon an IPO to be understated.



Picking the Players: Selection of Underwriters and Advisors

The Statistics

“On the Rebound”: Public IPO Filings, Withdrawals and Completions Since the 2008-2009 Recession; EGCs as a Percentage of Filings

Year	Initial IPO Filings	IPO Withdrawals	IPO Completions
2015	253	60	185
2014	387	55	296
2013	272	46	237
2012	150	85	141
2011	289	81	145
2010	276	65	169
2009	129	57	64
2008	157	112	51
2007	377	64	282
Total	2290	625	1570

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Year	EGCs % of Initial IPO Filings	EGCs % of IPO Withdrawals	EGCs % of IPO Completions
2015	84%	80%	94%
2014	86%	65%	85%
2013	83%	43%	84%
2012	58%	0%	48%
Average	81%	42%	81%

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An initial public offering requires close collaboration with the underwriters, legal counsel and auditors. Knowing the roles that the underwriters and advisors play and the right questions to ask them will help in choosing the right IPO team.

Top Questions to Ask When Selecting Underwriters

After company management, the underwriters will play the most critical role in the IPO—managing the marketing and sale of the company’s stock to public investors. An IPO typically has one lead underwriter but may have two. The lead underwriter or the company may select one or more additional underwriters to co-manage the offering, depending on its size and complexity. The lead underwriter has primary responsibility for and control over the underwriting of the offering, including helping to shape the IPO prospectus, running the road show, “building the book” of investor demand, agreeing with the company on the price per share for the IPO, determining the number of shares that co-managers may sell in the IPO and controlling the allocation of shares among purchasers in the IPO.

Peek at the Process

*“Know What You Need to Know”:
Factors to Consider in Underwriter Selection*

Primary factors to consider when choosing the underwriter are as follows:

Track Record. Has the underwriter led other recent, successful IPOs of companies similar in size, stage of development and industry? Has the underwriter recently begun IPO processes for companies that were not completed? Why?

Peek at the Process
“Know What You Need to Know”:
Factors to Consider in Underwriter Selection (cont’d)

Reputation and Experience. Does the underwriter enjoy a strong reputation with investors? Does the underwriter’s experience in the company’s industry enable it to provide special insights and quality advice and research? Does the underwriter have strong, sustained relationships with investors active in the company’s industry?

Commitment to the Company. Aside from reputation and experience, will the underwriter make the company’s offering a priority? What are the offering schedules of other, possibly larger or more valuable, offerings the underwriter is working on?

Aftermarket Support. Life as a public company only begins with the IPO. How has the stock price of other companies the underwriter has taken public recently performed in the months and quarters after the IPO? Will the underwriter continue to provide advice, introduce the company to potential investors and help interest other analysts in covering the company?

Analyst Coverage. While the underwriter is not allowed to promise analyst coverage while securing work on an IPO, does the underwriter have prominent analysts that cover the industry and similarly situated companies? How likely is it those analysts will cover the company?

Distribution Strength. Can the underwriter build a strong syndicate? Does the underwriter have strong distribution capabilities with retail (individual) investors and institutional investors? How effective is its retail sales force and its institutional sales force? Is the underwriter’s reach regional (e.g., only one coast), national or international?

The choice of underwriting firm is important, but perhaps just as important is the team that will actually work on the IPO. Getting the underwriter’s “A” team, and a team that is motivated about the particular IPO, will increase the likelihood of a smooth, orderly and professional offering and a positive reception from investors on the road show.

The underwriter will spend considerable time analyzing how to “position” the company with investors to achieve a successful offering. This marketing task involves more art than science. However, the company should engage in a dialogue with potential underwriter candidates to gauge how well the underwriters understand the company and its industry, and the factors that investors will focus on in deciding whether to invest. For example, explore which companies the potential underwriter believes are the company’s “comparables.” That discussion will help the company understand the sophistication of the underwriter’s knowledge about the industry and the competition as well as how keenly it grasps the unique value proposition the company offers the market. Other areas to probe with a potential underwriter include how the company’s expected valuation compares to the “comparables,” what other recent offerings have occurred in the company’s industry group, what factors drive the pricing of stocks in the industry, and to what extent the pricing of the company’s stock will depend on historical earnings, future earnings projections, revenue trends or other factors.

The company should seek a potential underwriter’s view of the company’s valuation and related offering price range for the IPO. The analytical rigor and persuasiveness of the underwriter’s response will help the company assess whether the valuation suggested by the potential underwriter when pitching for the IPO is likely to hold up or whether it will erode after the company becomes well engaged with the underwriter during the IPO process or, worse, when the company is presenting to potential investors in its road show. A company should also take with a grain of salt what it perceives as an overly optimistic valuation offered by a potential underwriter, however flattering. Once the company has publicly filed its Form S-1, there may be pressure to complete the IPO even if the valuation slips to a more realistic level, rather than face the unfulfilled expectations and questions that can follow an abandoned IPO.

PRACTICAL TIPS
“Let Me Ask You This”:
Key Questions to Ask Potential Underwriters

- How have the underwriter’s previous IPOs performed historically? How often has the underwriter priced recent IPOs within the filing range? In general? In this industry? If not, what were the reasons?
- What other firms would the underwriter anticipate adding to the syndicate? Will the underwriter allow co-managers in the syndicate? What does the underwriter think are the advantages and disadvantages of a co-manager?
- What does the underwriter recommend as to the IPO’s timing? Is one part of the year, or one part of the business cycle, better than another? How sensitive will the offering be to a drop in the stock market from current levels? How positive does the company’s financial trend need to be in order to make the IPO desirable? What financial statements need to be included in the IPO prospectus?
- What does the underwriter recommend for the offering’s size? What should the minimum number of shares offered in the IPO be? What are the underwriter’s views on allowing existing stockholders to sell shares (so-called “secondary” shares) in the IPO?
- Will any recent hiring of key officers and their lack of a track record with the company affect the timing or pricing of the offering? Which officers do the underwriters expect to be involved in the offering process?
- What are the underwriter’s views on whether to list on The Nasdaq Stock Market (“Nasdaq”) or The New York Stock Exchange (“NYSE”)?
- What is the expected underwriting discount? Confirm that the underwriter will bear its own expenses (except for blue sky law

PRACTICAL TIPS
“Let Me Ask You This”:
Key Questions to Ask Potential Underwriters (cont’d)

- and Financial Industry Regulatory Authority (“FINRA”) clearance legal fees). Will the underwriter accept suggestions for underwriter’s counsel?
- Does the underwriter suggest marketing the offering to retail (individual) investors, institutional investors or both? Institutional investors may be less likely to hold shares as long as retail customers. Retail purchasers can stabilize the aftermarket of a stock because they tend to hold stock for longer periods of time. However, institutional investors may understand a complex company or technology more readily than retail investors.
- What is the underwriter’s view of the time commitment and cities involved in the road show? Can the underwriter accommodate management’s schedule and time demands?
- Will the underwriter be able to grow with the company after the IPO by handling financings and mergers and acquisitions once the company is public? If the company needs additional capital, would the underwriter support a follow-on offering after the IPO?

A Note About Analyst Coverage

It is important to determine whether an underwriter has respected research analysts with expertise in the company’s industry. If the investment bank’s analysts are well regarded for their coverage of other companies in the industry, it reflects well on the investment bank’s decision to underwrite a company’s IPO, and investors will gain confidence from the fact that the company could receive expert, sophisticated analyst coverage after the offering. Reforms in the early 2000s sought to address potential conflicts of interest by restricting the role a research analyst can play in certain investment banking activities. After these reforms went into effect, underwriters were precluded from guaranteeing research coverage to a prospective IPO

candidate. The regulations also limit a research analyst's involvement in an IPO (for example, research analysts cannot attend road shows) and restrict the timing of when research reports can be published in conjunction with an IPO. In response to concerns that these restrictions inhibit smaller companies' access to the public markets, the JOBS Act included provisions that relaxed these restrictions. See Chapter 5 for more discussion regarding relaxation of analyst restrictions under the JOBS Act.

The Statistics *“Lonely at the Top”: Lead Underwriters in IPOs*

Each IPO has at least one “lead” underwriter, and many times two, even if ultimately a number of underwriters participate in the syndication of the offering. The company's primary contacts in the marketing effort are the lead underwriters, who provide input on the prospectus, identify and help the company resolve marketing concerns and organize the company's road show. In 2015, 63 firms led or co-led an IPO. However, there is a reason “bulge bracket” investment banks make that bracket bulge: the top 10 firms led the vast majority of offerings; 21 firms led or co-led only one IPO.

Lead Underwriter*	Number of IPOs	Percent of IPOs
Bank of America	43	23.2%
Citi	36	19.5%
Goldman Sachs	36	19.5%
JPMorgan	34	18.4%
Credit Suisse	32	17.3%
Morgan Stanley	31	16.8%
Jefferies	25	13.5%
Deutsche Bank Securities	22	11.9%
Barclays Bank	20	10.8%
RBC Capital Markets	17	9.2%

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* If there is more than one lead underwriter, each will have an IPO listed.

The Role of Legal Counsel and Auditors

Sophisticated, experienced legal counsel and auditors round out the key members of the IPO team. Legal counsel should have a strong understanding of the securities laws and the IPO process to guide the company through its offering. Legal counsel handles the preparation of the registration statement and advises the company on compliance with related disclosure requirements. Legal counsel will also play a key role in making required filings with the SEC, responding to SEC comments on the filings and resolving issues that the SEC may raise. Equally important, legal counsel should have strong expertise in the laws and regulations pertaining to public company disclosure and corporate governance requirements. This expertise will enable legal counsel to help the company make decisions before and during the IPO that will benefit the company during its public company life. For example, legal counsel will advise the company on the establishment of its corporate governance structure, policies and procedures so that the company can operate effectively and in compliance with relevant governance laws, regulations and stock exchange rules after the IPO. Legal counsel with strong public company experience can help the company set legal strategy so that it can continue to build value after the IPO, whether through mergers and acquisitions, additional financings or organic growth.

The company's auditors are also key players on the company's IPO team. The auditors will help the company comply with its disclosure obligations relating to financial statements and other financial information included in the registration statement. The SEC will assign accounting staff to review the company's financial statements and the other financial aspects of the company's disclosure, including the company's accounting methods and policies. The auditors may also serve as a liaison with the SEC's accountants on accounting issues relating to the offering.

The registration process with the SEC will proceed more smoothly if the auditors have the knowledge needed to anticipate and address possible SEC comments on the company's financial statements and related disclosures. Note that the auditor's SEC or “public company” review personnel will do a special review of the financial disclosures in the registration statement before it is filed with the SEC. The company should obtain assurances from its auditors that these review personnel will be available and accessible during the IPO so that the review is timely and does not affect the IPO timeline.

Chapter 3



Building Your Foundation: Public Company Considerations and Requirements

Organizational and Preliminary Matters

Basic Organizational Matters

A company needs to address several organizational matters during the run-up to the initial public offering. Some of these matters can be addressed relatively quickly, such as determining the optimal number and type of shares that can be issued under the company's charter; others will require greater analysis and time to resolve, such as the extent to which anti-takeover measures or other protective provisions should be implemented before going public. Legal counsel can help the company prioritize and resolve these matters so the IPO stays on time and on track.

A fundamental question is whether, on balance, it makes sense for the company to remain incorporated in its current jurisdiction of incorporation or to reincorporate into another state before going public. Companies incorporated in other jurisdictions may consider reincorporating in Delaware because it has a sophisticated corporate statute and a well-developed body of corporate case law, which lend clarity and predictability to how the laws will apply to board and corporate actions. Delaware also boasts the Court of Chancery, a special court dedicated to adjudicating corporate and other business law disputes. On the other hand, incorporation in Delaware comes at a price—the state levies an annual franchise tax that can be costly compared to the cost of being incorporated in many other states, which may have no annual franchise tax and only nominal annual filing fees. For instance, Microsoft reincorporated out of Delaware at least in part because of the cost relative to the perceived benefits. In addition, a company may believe it enjoys a sympathetic “home court” advantage in the legal courts of its home state if it is incorporated there, should litigation arise.

Equally important, a company will need to consider changes it should make to its charter documents (articles or certificate of incorporation and bylaws) to make them more suitable for a public company. The company should

complete this task before going public. Prior to the initial public offering, the stockholder base is typically small, and the process for obtaining stockholder approval is relatively uncomplicated. Pre-IPO stockholders generally will support charter and bylaw amendments when they view them as a stepping-stone to going public and achieving liquidity for their investments. After the IPO, obtaining stockholder approval of charter or bylaw amendments is more costly and time-consuming because it involves the preparation, filing and distribution of a formal proxy statement and solicitation of proxies in accordance with SEC regulations. In addition, post-IPO institutional stockholders will scrutinize proposed amendments more closely and are less likely to support certain changes, particularly anti-takeover provisions.

In particular, the company should determine whether to amend its charter to increase the number of authorized shares, especially of common stock. The charter should provide a sufficient number of authorized shares to facilitate the IPO and address other potential needs after the offering, such as future financings, equity compensation plans or acquisitions. The underwriters will provide input on the number and type of authorized shares because, among other things, they will want the company to implement a capitalization structure that will optimize pricing for the IPO. If the company has too many or too few shares outstanding to achieve the price per share range targeted by the underwriters, it can effect a forward or reverse stock split prior to the IPO to rightsize the number of outstanding shares.

The company should also consider whether to amend its charter documents to add any protective or anti-takeover provisions. We discuss these provisions in greater detail below under “Good Fences Make Good Neighbors—Anti-Takeover Considerations.”

PRACTICAL TIPS

“Prelude to an IPO”: 12 Pre-IPO Action Items

Considering an initial public offering and want to get started? Here are 12 steps to prepare your company so it can move swiftly when it ultimately decides to undertake an IPO.

- **Accounting**—Discuss in detail with your auditors the steps that should be taken to ensure that your financial statements

PRACTICAL TIPS

“Prelude to an IPO”: 12 Pre-IPO Action Items (cont’d)

and reporting processes are ready for the IPO and public reporting, including:

- understanding the number of years for which annual audited financial statements are needed;
- determining what changes may be required to ensure that the financial statements meet accounting standards that apply to public companies;
- undertaking any review of items of concern (such as historical stock option granting practices and related “cheap stock” issues) and identifying all significant accounting policy issues; and
- assessing whether the company has the staffing, procedures and IT systems needed to handle the demands of public reporting, including the speed and accuracy required for quarterly and annual reports.
- **Liquidity Rights**—Review stockholders’ and registration rights agreements to determine whether any current stockholders have a right to sell shares in the IPO. Plan for giving proper notice to stockholders with registration rights that apply to the IPO and obtaining waivers, if needed.
- **Compensation Arrangements**—Review director and employee compensation arrangements, particularly equity compensation plans, and plan for repayment and termination of any outstanding executive or director loans (which are prohibited under Sarbanes-Oxley).
- **Board of Directors**—Review the size and composition of the board of directors with an eye toward public company requirements and needs. Does the company’s board have sufficient independent directors and the right mix of skills for the

PRACTICAL TIPS

“Prelude to an IPO”: 12 Pre-IPO Action Items (cont’d)

board overall and for board committees? If necessary, begin recruitment of additional independent directors or directors with needed skills and experience. Review current directors’ and officers’ liability insurance policy (D&O insurance) and consider the need for enhanced coverage.

- **Communications**—Discuss with counsel the do’s and don’ts of pre-offering communications and establish an internal and external communications policy. Review the company’s website with counsel and consider changes necessitated by a potential public offering.
- **Corporate Governance**—Review internal staff and procedures in the context of public company compliance requirements.
- **Corporate Cleanup**—Review minute books and equity records to identify and resolve any issues.
- **Delaware?**—If the company is not incorporated in Delaware, consider whether to reincorporate in Delaware.
- **Litigation**—Identify and, if beneficial to the IPO, resolve any material outstanding disputes with employees, stockholders, customers or business partners.
- **Due Diligence**—Prepare for the due diligence process by organizing corporate, financial and commercial records, asking counsel for a due diligence request list and appointing due diligence coordinators at the company. Ensure that any material customer or supplier relationships and all material transactions are fully documented.
- **Confidential Treatment**—Work with counsel to identify material contracts required to be filed as exhibits to the company’s

PRACTICAL TIPS

“Prelude to an IPO”: 12 Pre-IPO Action Items (cont’d)

registration statement. Consider whether any material contracts include competitively sensitive terms for which the company may wish to obtain confidential treatment. Work with counsel to ensure that confidential treatment requests are timely processed to meet the overall schedule for the IPO.

- **Drafting**—Allocate responsibility for offering process tasks, and identify the company’s point person or persons for the IPO (often the chief financial officer or general counsel). Begin preparation of an initial draft of the prospectus.

Accounting Issues

Accounting issues often are some of the most complex and time-intensive matters to resolve before a company can go public. The company, the underwriters, counsel and the auditors should identify and resolve accounting issues as early as possible to prevent delays in the initial public offering process.

Heightened Financial Statement Scrutiny. Even if the company’s historical financial statements have been audited by a national auditing firm, it should not assume that its financial statements are ready for inclusion in an initial public offering registration statement. Although, as discussed in Chapter 5, the JOBS Act provides emerging growth companies the option to defer compliance with auditing standards that apply only to public companies’ financial statements, a company contemplating an initial public offering needs to work closely with its auditor to ensure that its financial statements comply with the relevant accounting standards and SEC rules both for the IPO registration statement and for post-IPO reporting requirements. Satisfying relevant financial statement requirements can be complicated by material acquisitions or dispositions before the IPO, which may require inclusion of historical financial statements of companies that have been recently acquired and/or pro forma financial statements for recent acquisitions or divestitures. A “Big Four” auditing firm typically requires that its SEC specialty group closely review the company’s financial statements before the

firm will consent to their inclusion in the IPO registration statement. As a result of this review, past accounting practices may become an issue. For instance, the company’s revenue recognition policies may be questioned. The company should be ready to explain its revenue recognition methodology and reasoning in the prospectus and to the SEC. Stock option expensing, segment reporting and critical accounting policies are other accounting issues that are often closely scrutinized by the SEC during the IPO process. In addition, accounting issues then in the public company spotlight or the press may cause the auditors to spend significant time reviewing, and in some cases reexamining, the company’s past records and procedures. This process can take significant time and may necessitate changes to the financial statements and related disclosures on which the company is relying for a successful offering.

Non-GAAP Disclosure. SEC rules impose some limits on the use of financial measures not made according to generally accepted accounting principles (“GAAP”) in registration statements filed under the Securities Act of 1933 (the “Securities Act”), the periodic reports and other documents a public company files with the SEC under the Exchange Act, and other public communications such as earnings releases. If the company wants to use any non-GAAP measure, it must (1) be able to justify its use by explaining why the measure is useful to an investor in understanding the company (and, if material, the other purposes for which management uses the measure) ; (2) include the most comparable GAAP measure with equal or greater prominence; and (3) reconcile the non-GAAP measure to the most comparable GAAP measure. Other than EBIT (earnings before interest and tax) or EBITDA (earnings before interest, tax, depreciation, and amortization), the company may not use non-GAAP liquidity measures that exclude charges or liabilities requiring cash settlement. Also, while the company may be able to present a non-GAAP financial measure to exclude a nonrecurring or extraordinary expense or gain, it may not attempt to smooth results by excluding expenses or gains characterized as “nonrecurring, infrequent or unusual” if similar expenses or gains were incurred within the prior two years or are likely to recur within the next two years. Non-GAAP disclosures have recently attracted intense scrutiny from the SEC, so a company and the underwriters must work carefully with counsel to ensure that the non-GAAP measures they are considering for the IPO prospectus meet the relevant rules and staff interpretive guidance.

Cheap Stock. Under Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 718 (“ASC 718”), companies must calculate the value of each equity compensation award they grant and recognize this value as an expense on their financial statements. Private companies by definition lack a public trading market to set the fair market value for their stock. In examining the company’s financial statements, the SEC may dispute the company’s determination of the fair market value used to set the exercise prices of stock options or to determine the value of stock awards. If the SEC concludes, for example, that the exercise prices of certain stock option grants were set below fair market value per share on the grant date (the so-called “cheap stock” problem), the SEC will require that the company record additional compensation expense in its financial statements. While this is a noncash expense, it nonetheless negatively affects the company’s financial statements and results and may negatively affect the market price for the company’s IPO.

As the date of the initial public offering approaches, the company’s stock is likely to be valued higher and higher, so adequately determining and documenting the fair market value of the company’s stock within 12 to 18 months of an IPO are important if the company hopes to avoid having to record additional compensation expense because of a “cheap stock” issue. A company may need to provide the SEC with specific data and information (including independent valuations) to support its determination of the fair market value that it used in calculating the value for each equity compensation award granted in the period leading up to an IPO, and the Internal Revenue Service and the SEC apply very different standards for scrutinizing these valuations.

Section 409A. Congress enacted Section 409A of the Internal Revenue Code in 2004 as a revenue-producing provision intended to stop common deferrals of executive compensation by subjecting nonqualified deferred compensation plans to earlier taxation and an additional 20% tax penalty. However, this legislation’s broad reach means that many common compensation practices for ordinary employees likewise potentially face earlier taxation and the tax penalty.

Most private companies find that stock options present their most significant area of exposure for Section 409A issues. Under Section 409A, the definition of “nonqualified deferred compensation plan” includes stock

options granted with an exercise price that is less than the fair market value of the company’s common stock on the grant date. Because private companies have no market for their stock, they face an increased risk that their stock options will be subject to Section 409A because the options may be determined to have been granted with an exercise price below the fair market value on the grant date.

As part of the due diligence process for an initial public offering, companies will likely be required to demonstrate for each stock option potentially subject to Section 409A that its exercise price was not below the underlying common stock’s fair market value on the grant date. Companies will also likely be required to demonstrate that the fair market value of the underlying common stock was determined through an appropriate process that complied with Section 409A. If the due diligence process uncovers Section 409A issues, resolving them may slow the IPO process.

Auditor Independence. In preparing to go public, the auditors will need to determine their independence from the company in accordance with auditor independence rules promulgated by the SEC and the Public Company Accounting Oversight Board. For instance, a company must confirm that its auditor has not performed impermissible non-audit services for the company that are reasonably likely to be subject to audit procedures (such as book-keeping, fair value appraisals, or outsourced internal audit services) and that there is no impermissible business relationship between the company and the auditor. Under the auditor independence rules adopted pursuant to Sarbanes-Oxley, such “conflicts of interest” are prohibited for public companies.

Liquidity Rights

Private companies, especially those that are venture- or private equity-backed, often grant registration rights to investors. These rights allow investors, subject to certain limitations, to include their shares in an IPO (or to even cause the company to undertake an IPO). The company should review the registration or other liquidity rights granted prior to the initial public offering to ensure that the company gives any required notices to the rights holder. If any investors are entitled to exercise registration rights and sell stock in the IPO, the company should evaluate with the lead underwriter whether the sales can be accommodated without compromising the success of the IPO. Often, investor registration rights or investor desire for liquidity

creates complex timing and relationship issues as the company and underwriters try to determine the appropriate offering size and price range. A company should attempt to manage process and expectations at an early stage.

Equity Compensation Programs

In recent years, equity compensation has become a hot topic for public companies. Once they go public, companies face different considerations affecting how they structure and administer their equity compensation programs.

A key goal for all stock compensation programs is to provide a benefit for employees and an incentive for employee performance that are at least as valuable as, if not more valuable than, the expense that the company recognizes in its financial statements with respect to this equity compensation. Both privately held and public companies must expense equity compensation under ASC 718, but this expense typically affects financial results for public companies far more significantly. In addition, public stockholders will scrutinize the value and expense associated with a company's equity compensation programs much more closely than private investors.

Peek at the Process “The Compensation Foundation”: Addressing Compensation Plans Before the IPO

Before going public, companies often adopt a new equity compensation plan that will replace existing equity compensation plans starting at the IPO. There are four key reasons.

Increased Flexibility. A company that is going public often desires to adopt equity compensation plans that have greater flexibility than their current plans. For example, public companies today increasingly use forms of equity compensation other than stock options, such as restricted stock units, to incentivize employees. If a company has an equity incentive plan that is limited to stock options, or otherwise does not provide adequate flexibility, it may wish to amend it, or adopt a new plan, so that the company has the latitude to grant appropriate types of equity incentives once it is public.

Peek at the Process “The Compensation Foundation”: Addressing Compensation Plans Before the IPO (cont'd)

Avoidance of “Hot Buttons” That May Trigger Institutional Stockholder Opposition. Institutional stockholders and stockholder activist groups often cast a critical and pitiless gaze on a public company's equity compensation plans. For example, Institutional Shareholder Services, Inc. (“ISS”), a leading proxy advisory firm that provides voting recommendations to institutional investors, analyzes a public company's compensation plans to determine whether they are structured in a manner that transfers too much stockholder equity from the company to plan participants as awards are granted and to determine the potential dilution of existing stockholders' voting power that could result from stock issuances under the plan. A company going public may wish to adopt a new equity compensation plan that meets ISS guidelines and excludes provisions the ISS opposes, for example, a plan provision that permits repricing of “underwater” stock options without stockholder approval. (Conversely, if any of these “hot buttons” are important to a company, it obviously would be easier to have such provisions in the plan before the company goes public rather than ask for stockholder approval of a plan with such provisions after the company goes public.)

Grandfather Protection From Certain Internal Revenue Code Restrictions. Section 162(m) of the Internal Revenue Code limits a public company's deduction for compensation to the chief executive officer and certain other executives to \$1 million unless such compensation meets the requirements of “performance-based compensation.” Time-vested restricted stock or restricted stock units generally will not meet the requirements of “performance-based compensation.” The requirements of Section 162(m) generally do not apply for at least three years (or until the plan is materially modified) to awards under a plan adopted before a company goes public if the IPO prospectus provides certain descriptive information regarding the plan. However, 2015 final regulations changed treatment for restricted stock units granted during this post-IPO grace period.

Peek at the Process
“The Compensation Foundation”:
Addressing Compensation Plans Before the IPO (cont’d)

Ease of Adoption. Adopting new plans or amending existing plans is relatively easy before an IPO. For a privately owned company, stockholder approval may not even be required, depending on the type of awards to be granted and the company’s governance documents. Even when stockholder approval is required, obtaining stockholder approval for a new equity compensation plan is typically much faster, simpler and less expensive for a privately owned company than for a public company. Private companies typically need to solicit a relatively small number of stockholders to obtain approval. A public company, on the other hand, must solicit a far greater number of stockholders and comply with the extensive federal proxy solicitation rules when obtaining stockholder approval.

Companies going public should also consider whether to offer employees the opportunity to periodically purchase shares of the company’s common stock after the IPO under a tax-qualified employee stock purchase plan (“ESPP”). ESPPs typically encourage broad-based employee stock ownership by permitting employees to use some of their cash compensation to purchase shares of the company’s common stock at a modest discount to the fair market value (generally up to a 15% discount). If the ESPP meets design and administration requirements to qualify under Sections 421 and 423 of the Internal Revenue Code, an employee subject to U.S. tax law who satisfies the applicable holding period requirements will receive preferred tax treatment upon sale of the ESPP shares. Companies going public often put an ESPP in place to be effective upon an IPO.

**Good Fences Make Good Neighbors—
 Anti-Takeover Considerations**

Once a company is publicly traded, anyone can acquire ownership of its shares. If a large portion of the company’s stock is publicly held (as opposed to held by insiders such as founders), the company is a potential target for a takeover. As part of pre-IPO planning, a company should consider whether

it would benefit by adopting various protective or “anti-takeover” protections before going public.

In general, well-designed and carefully considered anti-takeover protections are not designed to prevent a well-financed takeover of a company. Rather, the primary benefit of anti-takeover protections is to give a board of directors sufficient time and negotiating leverage to evaluate the offer, communicate with stockholders and negotiate with a potential buyer to preserve the company’s long-term objectives and maximize stockholder value. When potential buyers are forced to negotiate with the company’s board, as opposed to acquiring control of shares through open-market purchases or tender offers, the result is often greater value received for the stockholders.

A company must describe in its IPO registration statement any structural aspects of the company that may have an anti-takeover effect. Implementing overly restrictive anti-takeover protections may cause stockholders and prospective investors to suspect that the company is unwilling to entertain even advantageous takeovers and is more concerned about entrenching management than maximizing stockholder value.

Proxy advisory services such as ISS rate public companies and give them a governance rating (called a “QuickScore” by ISS). One factor in that score is a company’s anti-takeover protections. ISS generally views anti-takeover protections as pro-management and anti-stockholder. However, certain protections are more common and viewed as less troublesome by ISS than others. For example, ISS generally considers a stockholder rights plan, or “poison pill” (if adopted without stockholder approval), as a more potentially harmful anti-takeover device than an advance notice provision in the company’s bylaws, which requires stockholders to comply with certain procedures to bring business before a stockholders’ meeting. Many institutional investors rely on ISS’s corporate governance guidelines and recommendations for proxy voting. Companies should be aware of, and consider how their policies will affect, their governance rating with ISS and other major proxy advisory services, such as Glass Lewis. In addition, some institutional investors in the public markets yearn for the short-term returns driven by hostile takeovers. Consequently, anti-takeover protections may hurt the company’s relationship with certain institutional stockholders and potential investors. For these reasons, a company should take a measured and selective approach to the adoption of anti-takeover measures.

Peek at the Process
“The Recommended List”:
ISS Recommendations on Company Proposals

ISS generally recommends that stockholders vote against public company proxy proposals that may have anti-takeover effects. According to ISS’s 2015 U.S. Summary Proxy Voting Guidelines, ISS generally recommends that stockholders vote:

- Against proposals to classify the board;
- Against proposals to restrict or prohibit stockholders’ ability to act by written consent;
- Against proposals to restrict or prohibit stockholders’ ability to call special meetings;
- Against proposals to create a new class of common stock, such as low-voting or non-voting common stock; and
- For proposals requiring the adoption or redemption of poison pills to be put to a stockholder vote.

Additionally, ISS’s voting guidelines consider a number of anti-takeover or other protective provisions problematic in formulating voting recommendations on director candidates. The problematic practices that may lead to an ISS recommendation to withhold votes from one or more nominees to the board include a classified board structure, a supermajority vote standard, the inability of shareholders to call special meetings or act by written consent, a dual-class capital structure and a non-shareholder-approved poison pill or poison pills with certain features (such as so-called “dead-hand” or “modified dead-hand” provisions). Consequently, while adopting anti-takeover or other protective provisions before the IPO may be easy to accomplish, a company must consider the impact of such provisions on its relations with investors after the IPO. Many large institutional stockholders rely on ISS’s recommendations and/or have internal voting policies that frown on anti-takeover or other protective provisions. Companies that expect to have large institutional stockholder bases should consider the ISS’s policy guidelines when deciding what types of anti-takeover protections to adopt.

Common Anti-Takeover Protections

The following are common protections that may have anti-takeover effects for a Delaware corporation:

- *Classified Boards*—A board of directors may be classified by dividing the total number of directors into two or three classes, with each class serving a staggered two- or three-year term. If there are three classes, since no more than one-third of the directors can be replaced in any one year, a staggered board can help provide continuity and prevent a hostile acquirer from replacing more than one class within one year through a proxy fight. On the negative side, the adoption of a classified board can complicate board politics and decrease the company’s own flexibility to change its board’s membership.
- *Multiple Classes of Common Stock*—The certificate of incorporation may authorize two or more classes of common stock, such as one non-voting or “low-voting” class (e.g., 1 vote per share) and one “high-voting” class (e.g., 10 votes per share). Generally, companies with this capital structure will sell the low-voting or non-voting shares to the public, while founders and other early investors retain the high-voting shares—allowing them to maintain control of the company even if they no longer hold a majority of the outstanding shares. This capital structure can be an extremely effective takeover deterrent, since a third-party acquirer will generally be unable to acquire control of the company without the support of holders of the high-voting shares. However, many institutional and other investors frown on dual- and multi-class IPOs and recapitalizations, pointing out that the resulting capital structures can create a significant divide between the economic and voting interests of the stockholders and that this divide can decrease management’s accountability to the public stockholders.
- *No Stockholder Action by Written Consent*—The certificate of incorporation may prohibit stockholder action by written consent. This prohibition has the effect of giving all the stockholders the opportunity to discuss a proposed action at a stockholders’ meeting

and of preventing the holder or holders of a majority of the voting stock of the company from taking preemptive, unilateral action without a meeting.

- *Advance Notice Bylaws*—A company’s bylaws may provide that stockholders seeking to bring business before, or to nominate directors at, a stockholders’ meeting must provide timely advance notice to the company. The bylaws should also specify certain requirements for a stockholder’s notice to be in proper written form. These provisions are designed to prevent surprises from dissident stockholders at stockholders’ meetings.
- *DGCL Section 203*—Section 203 of the Delaware General Corporation Law, a business combination statute, limits any investor that acquires 15% or more of a company’s voting stock from engaging in certain business combinations with the company for three years following the date it passed the 15% threshold, unless certain conditions are met.
- *Blank Check Preferred Stock*—If a company authorizes “blank check” preferred stock, it empowers the board to create and issue one or more series of preferred stock with the rights and preferences that the board deems appropriate. Having blank check preferred stock, as well as a substantial reserve of authorized but unissued shares of common stock, provides the board with the means to take certain strong anti-takeover actions, such as implementing a stockholder rights plan, issuing a substantial block of shares (for valuable consideration) to a friendly party, reorganizing the company or making a defensive acquisition.
- *Stockholder Restrictions on Calling Special Meetings*—The certificate of incorporation may impose conditions on stockholders’ ability to call a special stockholders’ meeting. For example, the certificate may require that a stockholder request to call a meeting be made by holders of at least a specified percentage of the outstanding shares (for example, 25%) and that notice of the meeting be given at least 20 days before the meeting date. These conditions save a company from the considerable expense of calling and holding a special stockholders’ meeting if only a small stockholder minority desires it. Requiring a specified percentage of outstanding

shares to call a special meeting, if high enough, can also help defend against a hostile takeover. If the hostile acquirer does not own enough shares to meet the percentage, it may have to delay submitting a stockholder proposal or taking control of the board until the next regularly scheduled annual meeting. This delay may give the existing board time to develop appropriate alternative strategies or negotiate with the acquirer for a favorable transaction. Conversely, many states’ corporate laws provide that the percentage of stockholders required to call a meeting cannot exceed a maximum percentage specified by state corporate law.

- *Supermajority Voting*—A company’s certificate of incorporation may require supermajority voting for amendments to the certificate or bylaws. Requiring a supermajority vote of stockholders to approve certain amendments to the certificate and bylaws, also known as “lock-in” provisions, means that a hostile acquirer must control a greater share percentage to amend the certificate and bylaws to eliminate the company’s anti-takeover provisions. Supermajority voting requirements, however, reduce a company’s flexibility to make favorable changes to its charter documents. As a result, a company may choose to retain a majority-approval requirement for amendments to most of the provisions of the certificate but require a two-thirds or more supermajority approval for any amendment to certain provisions that provide takeover protections, such as provisions for a classified board, the right of stockholders to call special meetings and supermajority voting provisions for business combinations.
- *Poison Pill*—A stockholder rights plan, or “poison pill,” can be a powerful anti-takeover device. Its effect is to encourage acquirers to negotiate with the board so the board can seek to obtain the best value for stockholders in the event of an acquisition. Generally, a stockholder rights plan entitles stockholders to purchase common stock of the company at a highly discounted price if a third party acquires a substantial block of the company’s common stock, thus severely diluting the third-party acquirer. A company can adopt a stockholder rights plan through board action at any time, if sufficient authorized, unissued preferred shares or common stock shares

are available under the certificate of incorporation for issuance pursuant to the poison pill. Many institutional investors view stockholder rights plans with disfavor. Many companies consequently choose to defer adoption of a stockholder rights plan until after the IPO and adopt such a plan afterward only if special circumstances (e.g., substantial ownership by a dissident stockholder, consolidation in the industry or an undervalued stock price) warrant it.

Corporate Governance, Transparency and Oversight

The collapse of Enron in 2001 and other corporate failures focused public attention on the integrity and quality of disclosures in public companies' annual, quarterly and current reports. Congress mandated reforms to periodic reporting and corporate governance through Sarbanes-Oxley, and the SEC, NYSE and Nasdaq raced to keep pace. The financial crisis that began in 2008 led to the enactment of the Dodd-Frank Act, which mandated additional reforms.

As a result of the reforms, a public company must adopt and adhere to a number of written corporate governance policies and procedures. At the time of or shortly after an initial public offering, depending on which exchange the company lists its stock, a company must have or should at least consider having the following in place, most of which will be required to be accessible on the company's website:

For NYSE-listed companies:

- Audit Committee Charter
- Compensation Committee Charter
- Nominating (and Governance) Committee Charter
- Codes of Business Conduct and Ethics
- Corporate Governance Guidelines
- Whistleblower Procedures (although not formally required)
- Insider Trading Policy (although not formally required and usually not posted on website)

For Nasdaq-listed companies:

- Audit Committee Charter
- Compensation Committee Charter
- Nominating Committee Charter (if using one)
- Code of Business Conduct that also complies with the SEC Code of Ethics requirements
- Whistleblower Procedures (although not formally required)
- Insider Trading Policy (although not formally required and usually not posted on website)

These items are discussed in detail in Chapter 11, in addition to ongoing, post-IPO governance and compliance matters. When the SEC adopts final rules under the Dodd-Frank Act, companies undertaking an IPO may also need to consider implementing executive compensation recoupment (or "clawback") policies and policies relating to hedging by directors, officers and employees in order to prepare for life as a public company.

Chapter 4



Focus at the Top: The Board of Directors

Corporate Governance and the Public Company Boardroom

The ultimate responsibility for the oversight of a company's business and affairs rests with the board of directors. The board monitors financial reporting and public disclosure and oversees internal controls and compliance with laws. In addition to making choices about strategic focus and significant policies, the directors set the ethical tone of the business.

Assembling a Public Company Board

A well-constructed public company board will consist of a diverse collection of individuals who bring a variety of complementary skills relevant to the company's business and objectives. In deciding who should be on the board, companies should consider the candidates' financial and business understanding, industry background, public company experience, leadership skills, character and reputation.

The Statistics

"One Size Does Not Fit All": Board Size and Compensation

There is no "right" board size—it depends on many factors, such as the needs of the business and the talents and skills of the individual members—and the board size should be tailored accordingly. Nevertheless, as a company prepares for an IPO, there is usually some anxiety about whether its board has the right size and composition to satisfy the heightened governance needs that a public company faces. Pre-IPO companies often find themselves seeking to attract new board members and puzzling over what the appropriate kind of compensation would be for an individual signing on to help oversee a soon-to-be public corporation.

The Statistics

"One Size Does Not Fit All": Board Size and Compensation (cont'd)

In 2015, the median and average number of directors serving on boards of companies completing an IPO was seven, with 59.9% having six to eight directors. Approximately 21.6% had boards with nine or more members, 14.1% had boards with five members and 4.3% had boards with four or fewer members. Approximately 87% of the independent directors on those boards received compensation, with 69.2% receiving a combination of cash and equity, 10.3% cash only and 7.6% equity only.

Source: www.IPOVitalSigns.com, © 20016 CCH, a Wolters Kluwer Company. Used by permission.

Requirement of a Majority of Independent Directors

NYSE and Nasdaq require that a majority of a public company's directors be "independent" within a relatively short period of time following the company's proposed initial public offering. However, if possible, it is better if the majority of the board is independent at the time of the IPO, because investors may focus on this aspect of a company's governance at the time of the offering.

Independence

A company should determine whether current outside board members meet the definition of "independent" under the applicable rules and identify any new needs regarding board composition. If the company desires to add additional independent board members, it should begin the process of identifying and recruiting them several months in advance of the public offering, or as soon as practicable. Any agreement with a new director may have to be disclosed in the IPO prospectus.

An "independent director" is an individual who can exercise judgment as a director independent of the influence of company management. An independent director will be free from business, family or personal relationships that

might interfere with the director’s independence. Many institutional investors suggest that a “substantial” majority of a company’s directors be independent.

NYSE and Nasdaq rules specify a number of relationships that will disqualify a director from being independent. For example, each of the following may disqualify a director under NYSE and Nasdaq independence standards: current or previous (within the last three years) employment relationships with the company, receipt of compensation over \$120,000 from the company in any 12-month period in the last three years (other than for board service), certain relationships with the company’s auditor, significant business relationships between the listed company and another entity where the director serves as an executive officer or is a significant stockholder, and certain interlocking directorships.

Key Board Committees

A strong committee system is the hallmark of an effectively functioning board. Sarbanes-Oxley, NYSE and Nasdaq standards and SEC rules prescribe the existence, the composition and many of the activities of three core committees: the Audit, Compensation and Nominating and Governance committees.

All public companies will have an Audit Committee. NYSE and Nasdaq require a Compensation Committee composed of independent directors. NYSE requires a Nominating and Governance Committee, while Nasdaq requires that director nominees be selected or recommended to the board for selection by either a Nominating and Governance Committee comprised entirely of independent directors or by a board vote in which only independent directors participate. Prior to going public, the company should form each of these committees and draft their respective charters.

Pursuant to Sarbanes-Oxley, and the corporate government standards implemented by NYSE and Nasdaq, a public company’s Audit Committee generally must be composed of at least three individuals and must consist entirely of “independent” directors who may not receive any consulting, advisory, or other compensatory fees from the company, other than board or committee fees, or be an “affiliated person” of the company or its subsidiaries. In addition, Audit Committee members must be able to read and understand financial statements, and the public company must disclose in its annual

reports or proxy statements whether at least one member is a “financial expert” (and if not, why not). The company will also need to establish an Audit Committee Charter that complies with the SEC rules and the listing standards of the exchanges. Chapter 11 discusses in more detail the committee requirements.

Coming Aboard: A Director’s Guide to Deciding Whether to Serve on the Board of Directors

You have been asked to join a board of directors of a company preparing for its initial public offering? Congratulations! But wait—aren’t there some downsides that might go with this honor? What are they? And how do you distinguish between a board that you would like to join and one that it would be better to avoid? This section describes why to stop, look and listen before accepting a board seat and includes a practical set of questions to ask that will help lead you to the right decision.

The Big Picture

The best way to ensure that you will be an effective director is to join a board of directors that is already doing a highly effective job. In getting past the prestige associated with being asked to serve, a potential board member can ask questions that will enable him or her to make sure that this is an effective board that he or she would be excited to serve on.

A thorough inquiry into the company can include:

- Interviews with management, other board members, and industry and community contacts who would be able to help you establish the company’s reputation and culture;
- A review of available information about the company;
- A direct conversation about the “tone at the top”; and
- An exploration of the company’s culture of compliance with laws and with its own ethical code.

Coming Aboard: A Director's Guide to Deciding Whether to Serve on the Board of Directors (cont'd)

So How Do I Decide if This Is the Right Board for Me?

Most public company boards will call upon a director for a significant investment of time—and a responsible director will make a greater investment in time and risk than he or she can be repaid for, even if the board offers above-average compensation. In making this investment decision, a director candidate may consider five categories of information (discussed in more detail below):

- **Industry.** Is this the right industry for me? Do I have something to add? To learn?
- **Company.** Within the industry, is this the right company?
- **Stockholders.** Can I learn the nature of, and am I comfortable with, the stockholder base of this company?
- **Colleagues.** Am I comfortable with the board and the way that it conducts its business?
- **Skill.** Can I, considering the skills and the personality that I bring to the table, make an appropriate contribution to this board?

The Industry. When considering whether to join a board, a potential director either will have significant experience in the industry or will launch himself or herself into a new or relatively unknown industry and then become knowledgeable about that industry in a short period of time. Before deciding to devote a significant part of his or her professional life to this industry, a potential director should consider the following three ways to learn enough about the industry:

- Ask the company for industry analyses written by any nationally known consulting firms;

Coming Aboard: A Director's Guide to Deciding Whether to Serve on the Board of Directors (cont'd)

- Ask one of the major consulting firms, as a courtesy to you, to arrange a one-to-two-hour meeting or call with a consultant within the industry who can help you understand the key drivers in the industry; and
- Read the earnings announcements (and SEC reports) and listen to earnings conference calls of public companies in the industry.

In doing this, a director candidate can also become better at assessing the company and its role in the industry—in much the same way one would become familiar with a sector before closing an investment or a neighborhood before deciding to buy a home.

The Company. When asking questions about the company, the main goal of the director candidate is to be able to make an appropriate assessment—without being overwhelmed by data. Key information for assessing a company includes:

- **Its Financial Statements.** Read the company's financial reports, then have a direct conversation with the company's chief financial officer and controller. This is the most rapid way to understand the company's financial position. You should also consider asking for an interview by phone or in person with the company's outside audit partner.
- **Its Strategy.** Understand—and be able to articulate—the company's strategy. A key role of the board will be to understand the strategy and ensure that the CEO is the right person to fulfill that strategy. Consider trying to recite the strategy aloud after reading the company's material. Then sit down with the CEO and repeat it to see where you have it right and where wrong.
- **Its Risks.** Make inquiries regarding the company's internal policies and procedures. Does the company have the right

Coming Aboard: A Director's Guide to Deciding Whether to Serve on the Board of Directors (cont'd)

internal policies and procedures to identify the principal risks to the company? What have been the issues that have risen to the top through that system? How does the company address them?

Stockholders. Stockholder lawsuits are the source of virtually all board liability and boards of directors are increasingly expected to play a role in stockholder engagement. So before joining the board, a director should consider: Just who are these stockholders? Is the company a first-generation startup owned principally by the venture capital firms organizing the initial public offering? Do they expect to be the major stockholders after the offering? Is the company a more mature company, owned as a portfolio company of private equity funds, likely to have a strong institutional stockholder base soon after the public offering? Is the company a lightning rod for the attention of nonstockholder constituencies, such as environmental, safety, union or other groups? If so, these groups could, as stockholders after an IPO, have a keen interest in the work of the board in the future.

Colleagues—The Board. After becoming comfortable with the industry, knowledgeable about the company and aware of its stockholder base, the next step is to focus on whether the board functions well. This focus should be on the board's makeup and the processes by which it makes its decisions. Is there a diversity of experience, backgrounds, skills or areas of competence, and industry expertise? Who chooses the directors? The majority of the board after the IPO should be truly independent, which means being selected not by the CEO but by an independent nominating committee. What will the new director's role be? Does the board have a robust decision-making process? Have the board chair and CEO come from backgrounds where their boards have had a history of robust and active independent discussion and an active oversight role? The board should be involved in such matters as strategic planning and the regular review of the CEO's performance, as well as the business of

Coming Aboard: A Director's Guide to Deciding Whether to Serve on the Board of Directors (cont'd)

the board, such as approving an operating and capital budget and overseeing issues that touch on strategy.

Time and Skill. Finally, the director candidate needs to frankly assess his or her own willingness to make the time commitment, level of interest in the business of the company and relevant skills.

- **Time.** Think of board service on a public company board as being equivalent to 10% to 20% of your professional time. It could be as little as 10% for a well-functioning board with no major surprises. But for a chair of a critical board committee, such as the Audit Committee, or for someone who needs to participate in a special committee during major changes in the corporation, the board could easily take up 20% of your time over the course of a year.
- **Interest.** Is this company in this industry going to grab your attention enough to motivate you to devote a serious part of your professional life to it for the next several years?
- **Skills.** Why exactly are you being asked to join the board? Is it for your prestige or skill base? What are the needs of the board? Is there enough overlap with what you view as your true skills?

Take the Ethics Temperature

One topic that a strong board chair and CEO will welcome is a discussion of ethics at the company. The board is ultimately accountable for the selection of the CEO, and the board and CEO are jointly responsible for setting a "tone at the top" that helps protect against corruption and impropriety at a company. The systems that a board oversees (compensation incentives, a culture of hierarchy or open communication, etc.) can impact the ability of the organization to identify misconduct and address it promptly. A strong whistleblower program—under the oversight of the Audit Committee—will enable staff

Coming Aboard: A Director's Guide to Deciding Whether to Serve on the Board of Directors (cont'd)

members throughout the organization to feel that they can communicate ethical concerns.

How can a potential director do more than take the CEO's word at face value? After all, what CEO will not respond "of course!" to the question, "Do you have a good ethical tone"? This can be a new director's first effort to dig below the surface to understand the ethical tone of the organization. A potential director can speak to the head of the internal audit department, or to the compliance officer, and ask questions, including:

- "Can you help me understand the company's approach to ethics on a practical, day-to-day level—not a broad, philosophical level?"
- "How exactly do you communicate ethical imperatives to your staff, and can you summarize how you hear them from senior management?"
- "Who, quite specifically, is responsible for ethics at the company?" (Don't take "everyone" as a satisfactory answer.) "Is it an HR function? The chief compliance officer?"
- "Can you tell me—if you had an ethical concern this afternoon, to whom, and how, would you report it? Would you feel confident that when you went home tonight, there would be no retaliation or negative repercussions from of your report?"
- "Can you think of any examples in which ethical integrity has been rewarded at the company? Or examples of it being penalized—either explicitly or more subtly, through lack of advancement?"

Considering Board Membership? A Baker's Dozen Questions

"Thank you, but I've got some questions!" Here is a quick checklist to use for that first lunch or interview when you are invited to sit on a board.

The Industry

- Where does this company fit into the industry? Is it a leader? An up-and-coming member? A pioneer of a new industry sector?
- Is there a description of the company and its place in the industry that the company's investment bankers or one of the major consulting firms or other industry analysts have provided?

The Company

- What are the two or three most critical issues facing this company today?
- What is the company's strategy today—and how has that changed over the last two years? What are the top three most significant strategic issues for the company, and how do you see those impacting the company's strategy over the next three years?
- What is the financial state of the company? What are its financial controls, its procedures for developing accounting procedures, the strength of its chief accounting officer and chief financial officer, and its internal control functions (including internal audit)? Are you confident that the company has policies and procedures in place to identify its principal business and financial risks? In what circumstances have these issues in these areas been brought before the board of directors in the past several years?

Considering Board Membership? A Baker's Dozen Questions (cont'd)

Stockholders

- What is the principal makeup of the stockholders now, and how do you expect that to change over the next 18 months as the company expands its stockholder base? Do any of these stockholders have a representative—formal or by way of understanding or suggestion—on the board? If so, how will that change with the IPO?

The Board

- What is the role of nonmanagement directors? Is the chair an independent director, or if not, does the board have a lead independent director? Who chairs the Audit Committee? Who are the Audit Committee financial experts? Who currently chairs each committee or serves core functions on each of the committees?
- What is the role of the CEO on the board? Is the CEO going to be open to divergent or new opinions? Are the CEO and the more experienced members likely to be listeners?
- What is the procedure for selecting directors? Is the procedure managed by the Nominating and Governance Committee or principally by the CEO or an inside chair? Can I get bios for each director and information on who is considered independent?
- What is the procedure for oversight? What issues with respect to noncompliance with law or policy or procedure have come up in the past and how have they been handled by the Audit Committee or the board?
- What are the liability protections? Does the company have exculpation provisions, directors' and officers' liability insurance, or director indemnification agreements? Can you send me a summary? (As you review this information, analyze your

Considering Board Membership? A Baker's Dozen Questions (cont'd)

own personal D&O or umbrella policy and consider how that will fit with the company's D&O insurance.)

Your Skills and Fit

- Why am I being asked to serve on the board? What particular skills or experience do you think I bring that would improve the board, and how do those complement the skills of the other directors? How much time are board members spending on board or committee activities? What committees would I be expected to serve on, and what role would I be expected to play?
- What is the compensation? Is it in shares or in cash? Is it commensurate with the time that a director dedicates? What are the stock ownership guidelines?

Rules of the Road—Legal Responsibilities

Basic Board Duties

The cornerstones of a director's responsibilities are to act in good faith, to carefully fulfill the director's duty to be loyal to the company and to comply with the duty of care under applicable state law. To protect directors who have fulfilled the duty of care and the duty of loyalty, state corporate laws and corporate charter documents provide for indemnification and exculpation. In addition, most companies have directors' and officers' liability insurance.

Under most state laws, corporate directors primarily perform an oversight role. These laws typically provide, in one form or another, that all corporate powers be exercised by or under the authority of, and the business and affairs of the corporation be managed under the direction of, its board of directors.

A board director has principal duties of care and loyalty when overseeing the management of the company mean:

- *The Duty of Care.* This duty requires the exercise of “due care” in managing the business and affairs of the corporation. This means that directors need to inform themselves of information related to their decisions—and seek input from management or outside advisors as appropriate in making those decisions. Directors also need to develop procedures for board decision-making and oversee the procedures of the company. Procedures at the board level will help to ensure that the board has appropriate opportunities to consider and deliberate on all relevant, material information. By overseeing operating procedures, the board also ensures that the affairs of the company are being appropriately managed.
- *The Duty of Loyalty.* The duty of loyalty requires directors to act—without exception—in what would reasonably be believed to be in the best interest of the corporation and its stockholders. When a conflict of interest does arise, the board needs to implement mechanisms, such as recusing interested directors or delegating the decisions to a special committee made up solely of noninterested directors, to ensure that the transaction or other decision is considered in a way that allows the board to make a decision in full compliance with its duty of loyalty to the best interests of the company.

In general, as long as the directors act in good faith, comply with the duty of due care, and avoid any conflicts of interest or self-dealing, a board’s decisions will be subject to the “business judgment rule.” The business judgment rule is a principle that courts will respect the decisions of boards unless the decision has no “rational purpose.” This rule is designed to protect directors from judicial second-guessing, as long as they have gone about their decision-making process in an appropriate way. If those decisions were properly made, they are not second-guessed by the courts, even if they turn out to be bad decisions.

Securities Law Duties (and Liability) of Directors in Connection With an Initial Public Offering

Directors and officers incur responsibilities under the federal securities laws with respect to the registration statement for the initial public offering that

the company prepares and files with the SEC. The Securities Act imposes a high standard of care on a company’s directors and officers with respect to the accuracy and adequacy of the disclosures in the registration statement. Even a future director who, with consent, is named in the registration statement as being, or about to become, a director is as responsible as the current directors for the accuracy of the disclosure in the offering prospectus and overall registration statement.

Directors and officers may be liable for losses suffered by purchasers in the IPO if the registration statement contains material misstatements or omissions. The losses are generally measured as the difference between the price at which the securities were sold and the price on the day the suit is filed, regardless of whether the price subsequently recovers. The potential liability of directors and officers for losses is without regard to bad conduct. The purchaser does not have to establish that a director or officer had an intent to deceive, manipulate or defraud; even innocent misstatements or omissions may be sufficient to establish liability.

As a result, the company’s directors and officers must take care to ensure that the registration statement is accurate and contains without omission all material information relevant to making an informed investment decision. Information is material if there is a substantial likelihood that its disclosure would be viewed by a reasonable investor as having significantly altered the total mix of information made available and if there is a substantial likelihood that a reasonable investor would consider the information important in making an informed investment decision.

A director or officer can defend against liability for material misstatements or omissions only if the director or officer is able to prove that (a) with respect to the financial statements, the director or officer did not believe, and had no reason to believe, that the financial statements were incomplete or misleading, or (b) with respect to the rest of the registration statement, after a reasonable investigation, the director or officer had reasonable grounds to believe, and actually did believe, that the registration statement was not misleading and contained all material information necessary for an informed investment decision.

“Reasonable investigation” and “reasonable grounds for belief” are determined from the standpoint of a prudent individual acting in the management of his or her own property. The extent of a director’s or officer’s duty to

investigate depends on the facts and circumstances of a particular situation (and sometimes the vagaries of a particular court). At a minimum, however, each director or officer must read the registration statement carefully for accuracy and completeness and question the company's officers regarding any material matters that he or she believes may not be described accurately and fully. In addition, he or she must insist that any material misstatements or omissions be corrected. Most fundamentally, a director should take steps, whether by talking with management, the company's legal counsel and outside auditors, or otherwise, to ensure that the company is doing thorough "due diligence" to confirm that the registration statement contains completely truthful statements and does not suffer from omissions that might make the disclosure in the registration statement misleading.

Although the company's charter documents likely provide for indemnification of directors and officers in certain circumstances, the SEC takes the position that it violates public policy for an issuer to indemnify directors and officers against liabilities arising under the Securities Act. In Part II of the registration statement, the company is required to undertake that, unless the director or officer successfully defends against any suit for which indemnification is sought or there is controlling precedent in favor of the director or officer, the company will submit to an appropriate court the question of whether such an indemnification is against public policy and will be governed by the final adjudication of the issue. Accordingly, it is possible that directors and officers may not be able to rely on the company's indemnification provisions with respect to violations of federal securities laws. However, the imposition of these limitations on director and officer indemnification and reimbursement is rare because lawsuits involving a claim of Securities Act violations are often resolved, either in pretrial motions or through settlement, before a final adjudication of liability on that claim.

Indemnification of Directors and Officers and D&O Liability Insurance

Prior to the IPO, the company should ensure that appropriate indemnification provisions are in place for directors and officers, either in the charter documents or pursuant to contractual agreements, or both. Additionally, virtually every company purchases insurance prior to its initial public offering to cover liabilities arising from certain directors' and officers' actions on behalf of the company. D&O coverage for an IPO is expensive but should be

demanding by any person asked to serve on the board of a company contemplating an IPO. D&O insurance provides a potential source of reimbursement to the company for payments made to indemnify its directors and officers and can provide coverage to directors and officers directly. D&O insurance serves directors and officers by reducing their exposure to personal liability from potential gaps in the availability of indemnification, such as cases in which the company cannot indemnify its directors and officers because it is insolvent. Most D&O policies also include "entity" coverage, which insures the company directly for its liability on certain defined claims, though this coverage may dilute available coverage for directors and officers because any insurance reimbursements for the company's liability will be applied toward the overall insurance policy limits, leaving less coverage available for directors and officers. All D&O policies have coverage limits.

PRACTICAL TIPS *"Know the ABC's of Director and Officer Liability Insurance Coverage"*

Understand what each of Side A, Side B and Side C coverage means:

- Side A coverage—the most important—covers directors and officers if the company cannot indemnify them because of either legal prohibitions or insolvency.
- Side B coverage covers directors and officers indirectly by reimbursing the company for payments made in connection with indemnifying directors and officers, such as settlements. This coverage can be viewed more as a financing device rather than true insurance.
- Side C coverage—sometimes called "entity" coverage—covers the company for securities claims made against it. Directors should consider the effect of Side C coverage on overall policy limits. Because defense costs (which are always part of D&O policy limits) associated with litigation against the company and payments towards a judgment against or settlement by the company reduce the total amount of insurance coverage for all insureds, there is a greater risk of insufficiency to cover

PRACTICAL TIPS
*“Know the ABC’s of Director and
 Officer Liability Insurance Coverage” (cont’d)*

claims against directors and officers as a result of Side C coverage.

A director should also seek information as to whether the policy assures protection for the directors and officers. One way to ensure that directors and officers are protected is to include in the policy an “order of payments” provision requiring that, in the event of insufficient coverage to pay all claims, Side A claims are paid first. A second approach is to have a separate Side A-only excess policy that provides additional Side A coverage in the event that the underlying D&O policy limits are exhausted.

The JOBS Act: Emerging Growth Companies and the IPO On-Ramp

Introduction to the JOBS Act

The JOBS Act was enacted in April 2012 to spur job creation by improving access to capital for smaller companies. Among other things, the JOBS Act relaxed certain requirements relating to initial public offerings by a new category of issuers called “emerging growth companies” and eased certain post-IPO reporting burdens on these issuers. The benefits available to an emerging growth company, or EGC, under the so-called “IPO on-ramp” provisions include the ability to:

- comply with relaxed financial statement and accounting requirements;
- comply with the “scaled” disclosure requirements available to smaller reporting companies;
- submit a draft of the Form S-1 to the SEC for confidential, non-public review; and
- “test the waters” with institutional investors to gauge interest in the IPO.

After the IPO, the JOBS Act relieves a company from some of the requirements that apply to other public companies so long as it remains an EGC, including:

- an exemption from the Sarbanes-Oxley requirement to have the independent auditor audit the effectiveness of the company’s internal controls; and
- exemptions from certain provisions under the Dodd-Frank Act relating to advisory votes on executive compensation and certain executive compensation disclosure requirements.

The Fixing America’s Transportation Act (“FAST Act”) enacted in December 2015 included a number of enhancements to the JOBS Act IPO on-ramp provisions.

What Is an “Emerging Growth Company?”

The JOBS Act established a new category of issuer under the Securities Act and the Exchange Act—the so-called “emerging growth company,” or EGC. A company with less than \$1 billion in total annual gross revenue during its most recently completed fiscal year qualifies as an EGC. A company that initially qualifies as an EGC will continue to be deemed an emerging growth company until the earliest of:

- the last day of the fiscal year during which it has total annual gross revenue of \$1 billion or more;
- the last day of the fiscal year following the fifth anniversary of its IPO;
- the date on which it has, during the previous three-year period, issued more than \$1 billion in nonconvertible debt; and
- the date on which it is considered a “large accelerated filer” (i.e., a company that as of the end of its most recent fiscal year has been an Exchange Act reporting company for at least 12 months, filed at least one Annual Report on Form 10-K and had a public float as of the end of its most recent second quarter of \$700 million or more).

Under a grace period added by the FAST Act, a company that qualifies as an EGC at the time of the confidential submission or public filing of its Form S-1 but ceases to meet the emerging growth company definition prior to completion of the IPO may continue to be treated as an EGC until the earlier of the date it completes the IPO or the end of a one-year period beginning on the date it ceased to meet the emerging growth company definition.

The On-Ramp: Benefits Available to EGCs in the IPO Process

The JOBS Act provides EGCs a number of significant benefits that are intended to simplify the initial public offering process and eliminate perceived obstacles to going public:

Relaxed Requirements Relating to Financial Statements and Related Financial Information. While a company that does not qualify as an EGC must include three years of audited financial statements in its registration statement, an EGC is required to include audited financial statements for only the two most recent fiscal years. If an EGC elects to include only two years of audited financial statements, the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section of the Form S-1 need only discuss those two years. Although a large number of EGCs that completed IPOs from 2012 to 2015 took advantage of the relaxed financial statement requirements, EGCs have not universally embraced this benefit. A company should discuss with its lead underwriters whether marketing considerations weigh in favor of including three years instead.

Under the FAST Act and related SEC rules, an EGC may omit from its Form S-1 (whether confidentially submitted or formally filed) financial statements for certain historical periods if the company reasonably believes that such financial statements will not be required under the SEC’s age of financial statement rules (Article 3 of Regulation S-X) by the time the contemplated offering is launched. For example, if the audited financial statements for a particular year would not be required by the time the offering is launched, the initial Form S-1 may omit the financial statements for that period. A company that opts to take advantage of this relief must, however, amend the registration statement prior to the distribution of a preliminary prospectus to include all financial statements and related financial information then required under applicable SEC rules. This relief does not apply to interim period financial statements that are required under the SEC’s rules. Related relief from the SEC financial statement requirements for significant acquisitions (Regulation S-X Rule 3-05) is available if the EGC reasonably believes that such financial statements would not be required by the time the offering commences.

In addition, although a company that does not qualify as an EGC is required to include selected financial data covering at least five years, an EGC is not

required to include the selected financial data for any period prior to the earliest year for which audited financial statements are presented in the registration statement.

Scaled Executive Compensation Disclosures in IPO Registration Statement.

A company is generally required to include in its Form S-1 comprehensive data and other disclosures relating to executive and director compensation in accordance with Item 402 of Regulation S-K. These can be some of the most difficult and complicated disclosures required under the SEC's rules, particularly the disclosures mandated by the Compensation Discussion and Analysis, or CD&A, requirements. Fortunately, the JOBS Act provides that an EGC may satisfy the executive compensation disclosure requirements by complying with the scaled disclosure rules that apply to "smaller reporting companies" under Regulation S-K Item 402. These rules require compensation disclosures only for the company's principal executive officer (i.e., CEO), its two most highly compensated executive officers other than the CEO, and up to two additional individuals who would have been included but for the fact that they were not serving as executive officers at the end of the fiscal year. Also, by contrast to the requirements applicable to non-EGC issuers, the scaled disclosure rules for EGCs require the inclusion of fewer compensation tables, reduced information about director compensation, and minimal narrative disclosures. Most important, EGCs are not subject to the exhaustive CD&A requirements that apply to non-EGCs.

Confidential Submission of Draft Registration Statements. Prior to the JOBS Act, a private company formally initiated the IPO process by publicly filing its Form S-1 on the SEC's EDGAR system. As a result, the fact that an IPO was underway became public knowledge as soon as the Form S-1 was filed. Now, an EGC can start the IPO process by confidentially submitting a draft of its Form S-1 to the SEC staff for confidential, nonpublic review. The confidential submission procedure allows an EGC to complete much of the SEC review process before the Form S-1 is ever publicly filed. The vast majority of EGCs whose IPOs priced in 2012-2015 utilized the confidential submission process.

The confidential and nonpublic review of IPO registration statements under the JOBS Act is similar in many respects to the normal SEC review process. After the draft has been confidentially submitted, the staff of the SEC confidentially reviews the draft and issues a comment letter. The issuer thereafter

confidentially submits an amendment to the draft registration statement and correspondence responding to the staff's comments. This process may continue for several rounds, although an issuer can elect to exit the confidential process any time it chooses. Generally, the timing for issuance of the initial comment letter in a confidential JOBS Act review is the same—around 30 days—as it is for a normal Securities Act registration statement review, and the same holds true for later rounds of comments (where the turnaround time generally becomes more compressed the further into the process the company goes).

An issuer must make a public filing of the confidential drafts of its Form S-1 prior to the commencement of its IPO road show. Initially, the JOBS Act required these filings at least 21 days prior to the road show, but the FAST Act reduced that period to 15 days. If a company elects to publicly file its previously submitted confidential drafts, the staff's confidential comment letters and the company's confidential response letters will ultimately be made publicly available on EDGAR, generally within the same time frame as comment and response letters for non-confidential filings (i.e., around 45 days after the staff completes its formal review of the publicly filed Form S-1). But if the company elects not to pursue the IPO while still in the confidential phase of the review process (for example, due to adverse conditions in the markets generally or negative reactions from prospective investors contacted during the test-the-waters phase discussed below), the drafts of the Form S-1 submitted confidentially, the staff's comment letters and the issuer's response letters will remain confidential indefinitely.

Submission of a draft Form S-1 pursuant to the confidential JOBS Act process is not deemed to be a "filing," so no registration fee is due at the time of submission. A draft Form S-1 submitted pursuant to the confidential process must be substantially complete, including most exhibits, although like non-EGC registration statements it may omit the offering price and other specific offering-related details and may omit certain historical financial statements under the FAST Act relief discussed above. However, because the confidential submission of a draft Form S-1 does not constitute a filing for purposes of the Securities Act, the draft Form S-1 need not be signed by the company's directors or executive officers and is not required to include consents from the auditor or other experts. Should an EGC that has started the IPO process with confidential review decide to proceed with the IPO, the

Form S-1 needs to comply with all applicable SEC requirements at the time it is first publicly filed.

Test-the-Waters Communications. EGCs may “test the waters” with certain institutional investors before or after the filing of a registration statement for a public offering. An EGC’s communications with qualified institutional buyers, or QIBs, and other institutional accredited investors are exempted from the SEC’s “gun-jumping” restrictions, which are discussed in Chapter 7. This exemption, which covers both written and oral communications, allows an EGC (and its underwriters) to communicate with QIBs and institutional accredited investors to gauge interest in the IPO. These communications may occur either before or after the first public filing of the Form S-1. Test-the-waters communications are subject to the general antifraud provisions of the federal securities laws. During the review process, the staff of the SEC will often seek supplemental information on whether the EGC has communicated with potential investors under the test-the-waters exemption and request copies of any such communications that are in writing. Consequently, an EGC should work with its counsel, underwriters and underwriters’ counsel to ensure that there are no material inconsistencies between the information included in test-the-waters presentations and the information to be included in the IPO registration statement. Underwriting agreements for EGC IPOs include provisions relating to testing the waters, such as representations that the issuer has not engaged in test-the-waters activities or, where it has, an acknowledgement that the underwriters have been authorized to engage in test-the-water’s activities and representations regarding the accuracy of the materials used in test-the-waters activities.

Relaxation on Rules Restricting Analyst Reports and the Role of Analysts in EGC IPOs. For investment banks involved in a public offering, a combination of federal securities laws and self-regulatory organization, or SRO, rules limit the role of the firms’ research analysts in the public offering process and place restrictions on the publication of analyst reports at certain times. For example, FINRA rules prohibit research analysts at any firm that acted as a managing underwriter in an IPO from publishing research reports until 40 days after an issuer’s IPO has been completed (25 days for participating firms that do not act as managers or co-managers in the offering) and for the period beginning 15 days prior to and ending 15 days after the expiration of any lockup entered into in connection with the offering. The publication of a

research report around the time of a public offering has also raised concerns about whether the report is an “offer” or “prospectus” that does not comply with certain requirements under the Securities Act. In addition, rules adopted by the SROs under Section 15D of the Exchange Act (or related interpretations of those rules) prohibit analysts from participating in meetings with companies’ management and investment banking personnel or investors. They also require legal or compliance personnel to act as intermediaries with respect to communications between investment banking and research personnel about the contents of research reports.

Many criticized these restrictions as inhibiting the ability of smaller companies to access the public markets for the first time. As a result, the JOBS Act relaxed these restrictions in many ways:

- It excepted “research reports” published by a broker-dealer regarding an EGC that is the subject of a proposed public equity offering from the definition of “offer” for purposes of certain provision in the Securities Act; and
- It barred the SEC or any national securities association from having any rule relating to an EGC IPO that:
 - Restricts, based on a functional role, which broker-dealer employees may arrange communications between securities analysts and prospective investors;
 - Prohibits research analysts from participating in communications with company management in the presence of non-research personnel (such as investment banking or sales force personnel); or
 - Prohibits publication or distribution of a research report within any specific period of time following an EGC’s IPO or prior to the expiration of a lockup agreement entered into in connection with the IPO.

FINRA has since amended rules to implement the changes mandated by the JOBS Act (as well as some that were not, such as an amendment that eliminated the prohibition of research reports during the 15 days after the expiration of a lockup entered into in connection with an EGC’s IPO). Although the JOBS Act relaxed certain restrictions that limited the role of

research analysts in initial public offerings of EGCs and on the publication of pre-deal and post-deal research reports on EGCs, these changes have not yet had a significant impact on actual practices. In particular, because the JOBS Act provisions described above did not supersede the Global Research Analyst Settlement entered into by a number of major investment banking firms in 2003—which codified many of the restrictions on analysts and research reports—and failed to address certain other legal concerns relating to analyst research reports, investment banks have been reluctant to change their practices with regard to the role of analysts in the IPO process and publication of research reports.

Other IPO Considerations

The SEC expects EGCs in the Form S-1 for their IPO to disclose the fact that the company is an EGC, summarize the exemptions available to it as an EGC, and discuss the risks related to its status as an EGC—for example, the risks to investors due to reduced disclosures, the exemption from “say-on-pay” requirements and the exemption from the requirement to have an independent auditor attest management’s annual assessment of the effectiveness of the EGC’s internal controls.

Other Benefits Available to Emerging Growth Companies

The JOBS Act eases certain other burdens on EGCs associated with being a public company, so long as the EGC continues to qualify as an emerging growth company:

Deferred Compliance With Sarbanes-Oxley Internal Control Audit Requirement. Generally, a public company must annually assess the effectiveness of its internal control over financial reporting and include in its Annual Report on Form 10-K a report on management’s assessment of internal controls. In addition, the Form 10-K must include an audit of management’s internal control report by the company’s independent auditor. These requirements were generally perceived to be the most demanding and costly burdens imposed by Sarbanes-Oxley. The JOBS Act exempts an EGC from the requirement under Section 404(b) to include an audit of its internal control assessment for as long as it remains an EGC, which could be up to five years after the IPO.

Extended Transition Period for Compliance With New or Revised Accounting Standards. The JOBS Act allows EGCs to defer compliance with new or revised accounting standards until the standards become applicable to private companies. In addition, EGCs may prepare financial statements included in their IPO registration statements, and in their periodic reports filed after the IPO, using the accounting standards that apply to private companies. These amendments were intended to relieve some of the accounting burdens faced by newly public companies. Even so, many EGCs have elected not to take advantage of this JOBS Act exemption. EGCs and their advisors recognize that investors and analysts may have concerns about the lack of comparability of financial statements prepared under private company accounting standards to non-EGCs’ financial statements. Early in the IPO process, a company that qualifies as an EGC should discuss with its lead underwriters the pros and cons of taking advantage of the extended transition period for new or revised accounting standards. Although the JOBS Act generally allows an EGC to pick and choose at any time which exemptions from non-EGC requirements it intends to take advantage of, an EGC that wishes to opt out of the extended transition period for complying with new or revised accounting standards must do so at the time of its IPO. That choice must be made explicit in the first registration statement submitted or filed with the SEC and is irrevocable.

Exemption From Certain PCAOB Requirements. EGCs are exempted from rules adopted by the Public Company Accounting Oversight Board (“PCAOB”) relating to mandatory audit firm rotation and auditor discussion. To date, however, the PCAOB has not adopted mandatory auditor rotation or auditor discussion and analysis requirements.

Scaled Executive Compensation Disclosures in Post-IPO 10-Ks and Proxy Statements. An EGC may continue to comply with the scaled executive compensation disclosure requirements discussed above for annual reports on Form 10-K and annual proxy statements filed by an EGC after its IPO. Although non-EGCs must include executive compensation data for up to three fiscal years, EGCs that elect to comply with the scaled disclosure requirements applicable to smaller reporting companies need not include executive compensation data for more than two years.

Exemption From “Say-on-Pay” Requirements. Generally, public companies must provide their shareholders:

- At least once every three years, an advisory vote on executive compensation (known as the “say-on-pay” vote);
- At least once every six years, an advisory vote on the desired frequency—every one, two or three years—of the say-on-pay vote (known as the “say-on-frequency” vote); and
- When soliciting proxies to approve a merger, sale or other business combination transaction, an advisory vote on compensation arrangements in connection with the transaction (known as the “say-on-golden-parachute” vote).

However, EGCs are exempted from all of these requirements pursuant to the JOBS Act.

Exemption From Other Dodd-Frank Disclosure Requirements. The Dodd-Frank Act required the SEC to adopt new rules pertaining to compensation-related disclosures, including a requirement to disclose the ratio between the CEO’s total compensation and the median total compensation for all other company employees and a requirement to disclose certain pay-for-performance information. As of early 2016, the SEC had adopted the CEO pay ratio rules, which will become effective for public companies for their first fiscal year after January 1, 2017. The SEC also has proposed, but not yet adopted, the pay-for-performance disclosure rules. The JOBS Act exempts EGCs from both of these requirements.

The IPO and the IPO Process



The company has decided go public. Management is interviewing potential underwriters, and the company is methodically working through pre-IPO considerations and actions to get ready. But ready for what? What exactly is involved in the process of taking a company from being privately owned by its founders, investors or employees to being a company with a public trading market for its stock?

In a nutshell, the IPO process entails the company working with its underwriters and advisors—primarily company counsel, underwriters’ counsel and the company’s auditors—to:

- Prepare a prospectus to market the offering;
- Conduct due diligence;
- File the prospectus and related registration statement with the SEC;
- Respond to and satisfy the SEC’s comments to the registration statement;
- Market the offering on a “road show” to potential investors;
- List the stock on a stock exchange;
- Have the SEC declare the registration statement “effective”; and
- Price and then close the sale of company stock in the initial public offering.

This chapter provides an overview of the registration process, the due diligence process, the registration statement and disclosure requirements and the stock exchange listing.

During the IPO process, a company must comply with the Securities Act, the Exchange Act and the applicable stock exchange rules. At the same time, the underwriters' involvement with the IPO must comply with the rules of FINRA.

Recently, the IPO process has been updated for certain companies by the JOBS Act and the FAST Act. The JOBS Act and the FAST Act aim to, among other things, streamline the IPO process for companies that qualify as “emerging growth companies.”

Overview of the Registration Process— the Pre-Filing Period, the Waiting Period, Effectiveness and the Post-Effective Period

The IPO process centers on registering the company's stock offering with the SEC. The registration process involves three stages: (1) the “pre-filing period”—the period before the company files the initial registration statement with the SEC; (2) the “waiting period”—the period between the initial filing and the date that the SEC declares the registration statement “effective”; and (3) the “post-effective period”—the period in which the stock can actually be sold to the public.

The Pre-Filing Period

The pre-filing period is the most time-intensive (outside of the time management spends on the road show) and the most sensitive to premature public disclosure. During the pre-filing period, the company decides to proceed with an IPO, selects the underwriters, facilitates due diligence and drafts the registration statement. The pre-filing period is also called the “quiet period” because improper public statements about the company or the offering during this time could jeopardize the IPO. Emerging growth companies, however, have some flexibility about communications with investors during this quiet period. Emerging growth companies may “test the waters,” that is, communicate with qualified institutional buyers and institutional investors before or after the IPO registration statement is filed to determine interest in a potential IPO. Chapter 7 provides guidance on this and other publicity and communication by the company.

Near the beginning of the pre-filing period, the company holds an “organizational meeting” (described in more detail in Chapter 8) where the working group—the company, the underwriters, counsel for the company and underwriters, and the auditors—first meet. After this initial meeting, the working group meets regularly over a period of about four to six weeks to draft the registration statement. These drafting sessions culminate in the filing of the registration statement with the SEC.

The Statistics “Beat the Clock?": Time in Registration

Once the registration statement is filed with the SEC, it is natural to be optimistic when estimating the duration of the SEC review process and targeting an offering date. In many cases, the optimism is warranted, but sometimes it is wishful thinking. For domestic IPOs completed in 2015, it took on average 74 days from filing the initial registration statement with the SEC to completing the offering, with a very wide range in the number of days for each IPO. The shortest time to completion was 28 days, and the longest 496 days. Both of these cases probably involved unusual circumstances. So where does the average IPO fit in this range? Only 25 of 185 domestic IPOs in 2015 were completed in less than 30 days, but 104, or 56.2%, were completed between 30 and 60 days. Bear in mind that this does not include the time necessary to prepare the registration statement before it is filed with the SEC or even time associated with confidential submissions with the SEC. A registration statement is more likely to pass through the SEC comment process quickly if it is filed after it has been carefully prepared and well-drafted and then submitted confidentially for review and comment, rather than filed prematurely.

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Filing the Registration Statement and the Waiting Period

The registration statement becomes public once it is filed with the SEC. However, emerging growth companies may submit their IPO registration statement to the SEC on a confidential basis. This option is helpful for

companies who want to be ready if market windows open up but are concerned about publicity from an uncompleted IPO.

Once the registration statement is submitted confidentially or filed with the SEC, the waiting period begins, and, as the name implies, the company waits for the SEC to review and comment on the registration statement. After completing its initial review, the SEC delivers a “comment letter” to the company outlining questions and issues concerning the registration statement. Among other things, the letter addresses the registration statement’s compliance with the Securities Act, certain aspects of the disclosure and accounting matters. The working group typically prepares and files one or more amendments to the registration statement and one or more written “comment letter responses” to the SEC and works with the SEC to address and resolve the issues.

During the waiting period, the company and the underwriters also organize the marketing efforts, including the road show presentation, for the offering. If the company is an emerging growth company, it can continue to communicate with certain types of investors about their interest in a potential IPO. This process is called “testing the waters.” The company also continues responding to due diligence questions from the underwriters’ counsel and preparing itself for life as a public company.

Near the end of the SEC review process, the company and underwriters will go on the road to market the offering to potential investors. Later in this chapter, we provide an “Offering Roadmap” to give an overview of the timing of the SEC review process and the initial public offering stages.

If the company had confidentially submitted its registration statement with the SEC, it must publicly file a registration statement at least 15 days before any road show can commence.

Effectiveness and the Post-Effective Period

After the end of the road show, the company requests that the SEC declare the registration statement effective so that its sales can be made pursuant to the registration statement. If all issues have been resolved, the SEC will declare the registration statement effective. On the day the SEC declares the registration statement effective, the underwriters and the company hold a pricing call where the underwriters recommend to the company the price at which the underwriters will purchase the stock from the company for resale

to the public. Prior to or during the formal pricing call, the underwriters, to different degrees, provide the company with indications of the investors’ interest and other relevant market data indicating the appropriate price range for the company’s stock. On the pricing call, a committee of the board, the Pricing Committee, formally approves the price at which the stock will be sold to the underwriters for resale to the public, usually giving significant consideration to the underwriters’ recommendation. After the pricing call, the underwriting agreement is executed, and either that night or before the market opens the following day, a press release announcing the terms of the offering is issued. The next day the underwriters sell the company’s stock to investors and trading in the company’s stock begins. Chapter 10 provides a Pricing Schedule that highlights in more detail the concluding events to a successful IPO.

After the IPO, the company must comply with various governance and compliance requirements (whether from the SEC, NYSE or Nasdaq) and the reporting and other regulatory requirements of the Exchange Act. During the IPO process, the company will make arrangements in order to comply with these requirements, some of which must be met at the time of initial filing of the registration statement and others of which must be met at the time the company goes public. Companies that qualify as emerging growth companies may benefit from the JOBS Act and the FAST Act, which ease the requirements of being a newly public company by, among other things, lowering the level of compensation-related information a company must disclose, exempting the company from new U.S. GAAP accounting standards not applicable to private companies and exempting the company from providing auditor attestation reports on internal financial reporting controls. Chapter 11 provides a more detailed discussion of these governance and compliance requirements, as well as the reporting and regulatory requirements.

Possible Dangers of Recent Private Placement

An issue can arise when a private offering occurs in close proximity to the filing of a registration statement for an IPO. The good news is that under the Securities Act, a company can privately sell its stock to raise that last round of capital required to get the company to the IPO stage. The bad news is that the SEC may “integrate” the private placement, which would otherwise be exempt from SEC registration, with the IPO. Integration means that the two offerings are treated as one issuance, destroying the private placement’s

exemption from registration and subjecting the company to liability in connection with the private placement for violation of the disclosure and other legal requirements under the Securities Act.

Avoiding integration is essential if the company wants to conduct a private placement prior to or during registration of its initial public offering. There are two ways to avoid integration. First, the company may utilize a statutorily defined safe-harbor provision. Second, the company can structure the two offerings as two distinguishable, separate plans of financing, and, therefore, not integrated.

Rule 502 under the Securities Act provides that exempt private offerings under Regulation D (the most often used exemption for private offerings) completed more than six months prior to the IPO will not be integrated with the IPO. In addition, if a company begins a private offering but abandons it to pursue an IPO, Rule 155 under the Securities Act can provide a statutory safe harbor to preserve the legality of the IPO under certain conditions. Under Rule 155, a private offering will not be integrated with a later IPO if:

- no securities were sold in the private offering;
- the company and persons acting on its behalf end all of the private offering activity before filing the registration statement for the IPO;
- the preliminary and final prospectuses for the IPO include certain information about the abandoned private offering; and
- the IPO registration statement is not filed until at least 30 days after the end of the offering activity in the private offering, unless the private placement securities were offered only to accredited investors (or persons reasonably believed to be accredited investors) or persons who satisfy certain knowledge and experience standards under Rule 506 of Regulation D.

If a statutory safe harbor is unavailable, the determination as to whether separate offers and sales are part of the same offering and, therefore, integrated, will be a question of fact that depends on the particular circumstances of each case. The SEC has listed five questions that it would use to determine whether two ostensibly separate offerings should be integrated and treated as a single offering: (1) Are the offerings part of a single plan of

financing? (2) Do the offerings involve issuance of the same class of securities? (3) Are the offerings made at or about the same time? (4) Is the same type of consideration to be received? (5) Are the offerings made for the same general purpose? Although the five-factor test provided by the SEC offers guidance on the integration issue, the factors are not exclusive and do not offer any “bright line” rules to resolve the issue. Each determination will turn on the unique facts and circumstances surrounding the offerings.

The nonexclusivity of the five factors is highlighted by the SEC’s position in *Black Box, Inc.*, where the SEC held that a private offering conducted after the filing of a registration statement would not be integrated with a public offering. Instead of citing one of the five factors to support its conclusion, the SEC appears to have based its determination on the nature and number of the offerees involved in the private placement.

If a company has recently issued securities prior to an IPO, or anticipates issuing securities during the IPO process but not as part of the IPO, the company should contact its legal counsel for advice. The “Black Box” analysis of how the private offering can be structured to avoid integration takes time and should not be treated casually.

Learn and Tell: Fundamentals of Due Diligence and Disclosure

Due Diligence: Getting a Head Start

Due diligence is vital to an initial public offering, even if unglamorous and painstaking. In the due diligence process, the underwriters, the company and their respective counsel carefully review information and background materials regarding the company. Due diligence takes many forms, including listening to formal management presentations, asking numerous questions of management during prospectus “drafting sessions” to understand the company and ensure it is accurately portrayed, and examining a large volume of written materials about the company. The company compiles the written materials, usually in response to an extensive due diligence request list.

Broadly, the working group uses due diligence to determine and verify the information required to be disclosed in the registration statement for the IPO. Practically, due diligence achieves three main goals. First, it allows the company to ensure it accurately discloses the information technically

required to be disclosed in the registration statement and helps the company to avoid material misstatements or misleading omissions in the registration statement for which it (and its officers and directors) could be liable. Second, it provides the underwriters a “due diligence defense” to liability under the securities laws. Underwriters can incur liability for material misstatements and omissions in the registration statement but can maintain a defense to liability if the underwriters establish that, after a reasonable investigation, they have reasonable grounds to believe the information in the registration statement was true and there were no material omissions. The underwriters establish this defense through the due diligence process. Third, company counsel conduct due diligence so they can provide a required written statement to the underwriters confirming that counsel is not aware of any material misstatement or omission in the registration statement or prospectus.

The underwriters’ due diligence request list is usually very broad and covers the company’s charter documents and corporate records, including option records, stockholder information, board minutes and records, information about ongoing or recent litigation or investigations, all permits and related citations, a wide range of personnel information, real and intellectual property documentation, finance and tax information and material agreements. Underwriters’ counsel will provide a detailed checklist of the required due diligence materials. Generally, one person at the company is the designated due diligence contact. Compiling the due diligence materials in an organized manner will enable the working group to draft the registration statement in a more efficient manner and will also reveal early on any issues that need to be resolved for a smooth, successful IPO.

PRACTICAL TIPS *Choosing an Electronic Data Room*

Electronic (or “virtual”) data rooms can help you manage the logistics of compiling due diligence documentation and responding to due diligence requests and are a fairly common way to manage the diligence process. These hosted websites provide the working group with secure access, via an online portal, to due diligence documents uploaded by the company. Consider the following when choosing an electronic data room vendor:

- How expensive is the vendor?

PRACTICAL TIPS *Choosing an Electronic Data Room (cont’d)*

- What kind of support services are available to help you use the data room?
- How easy is it to open and view documents? This basic user experience can vary widely.
- How effective is the search function? Can you search the contents as well as the titles of uploaded documents?
- Can you upload and download documents in bulk?
- Can you print the index or transfer it to Excel?
- How easy is it to control who has access to which documents?
- How easy is it to track who has seen which documents?
- Which vendors do counsel or underwriters recommend?

D&O Questionnaire

Any person buying part of a company would want to know quite a bit about the company’s leaders and key owners. It is no surprise, then, that the company must disclose detailed information about its directors, officers and major stockholders in the IPO registration statement. This information includes share ownership, compensation, biographical information and participation in certain transactions with the company. As part of the due diligence process, each director, officer and major stockholder completes and signs a relatively extensive questionnaire, referred to as the “D&O questionnaire,” to elicit this information. In addition, each director, officer and major stockholder answers questions regarding affiliation with FINRA. Underwriters must supply FINRA with certain information about company insiders as part of obtaining FINRA approval of the compensation the underwriters will receive in connection with the offering.

Backing Up the Disclosure

As the IPO prospectus is drafted, underwriters' counsel will ask the company to provide documents that support the facts asserted in the prospectus. For instance, if a company states that it is the leading provider of a product, the company will have to provide written factual support for that claim. The SEC may also ask the company for this type of support. For organization, underwriters' counsel should provide a "circle-up" identifying all items in the registration statement that the company is expected to back up. The company should respond by providing documents that are organized and keyed to the request. This process and support is separate from financial information support provided by a comfort letter from the company's auditors discussed next.

Getting Comfort From the Auditors

As part of due diligence, the underwriters request "comfort" from the company's auditors regarding the financial data in the registration statement. The auditors respond by rendering a "comfort letter" to the underwriters on the date the registration statement becomes effective and the offering is "priced." The auditors issue a bring-down comfort letter several days later at the closing of the offering.

The comfort letter includes statements concerning the company's audit, compliance of the financial statements included in the registration statement with the securities law requirements, negative assurance regarding changes in financial results during interim periods, negative assurance as to pro forma adjustments (if pro forma financial statements are included in the registration statement), statements concerning the procedures performed by the auditors and confirmation of each item of financial data in the registration statement.

What is actually included in the letter depends on the underwriters' counsel's request and what information the auditors can document. The auditors will not necessarily give comfort on every number in the registration statement, because the nature of the company's internal accounting controls and records affect the auditors' ability to provide comfort on certain numbers. Generally, the auditors will give comfort on financial data that tie to the books and records of the company. However, what the auditors are willing or able to provide comfort on can be a significant issue. By the same token, the underwriters will not likely tolerate a prospectus that contains financial

data for which the underwriters do not obtain sufficient backup or due diligence, such as that contained in a comfort letter. Accordingly, underwriters' counsel and the auditors should communicate early in the process and identify any areas of concern that may need resolution. Also, the underwriters will require SAS 100 review of any interim financial statement included in the prospectus.

Underwriters' "Business" Due Diligence

Beyond a review of corporate documents, the underwriters will need to engage in "ground level" due diligence to understand the company's business. Underwriters typically want to visit significant facilities, participate in operational tours and speak with major suppliers and customers. The underwriters also spend significant time examining and assessing the company's financial results and projections with management to grasp the story behind the numbers and its implications for the offering. The underwriters will also conduct a due diligence call with the company's auditors outside the presence of management to obtain an independent view on the company's audit and accounting processes.

PRACTICAL TIPS

"Winning the Paper Chase": Preparing for Due Diligence

Preparing ahead for due diligence decreases the disruption caused by an IPO and increases management's ability to "stick to business" during the offering. Here are some simple steps to prepare:

- Ask counsel for a detailed due diligence request list early in the IPO process.
- Designate one person at the company to be the point person for due diligence; make sure each business unit will be responsive to the point person.
- Organize responsive documents in a manner consistent with the request list; correlate the response to the numbered items on the request list.
- Control the flow of documents and keep an organized record of requests (including follow-up requests) and responses.

PRACTICAL TIPS
*“Winning the Paper Chase”: Preparing for
 Due Diligence (cont’d)*

- Anticipate that the working group will have additional requests or questions and set aside time to provide supplemental information.
- Obtain, organize and provide supporting documentation for factual assertions in the prospectus.
- Be patient—the due diligence process is tedious but underlies the integrity of the initial public offering.

Disclosure—Drafting, Filing and SEC Review

Full and fair disclosure of material information, enabling an investor to make an informed choice whether to invest in a company, is the bedrock legal principle underpinning the regulation of the U.S. securities markets. The same is true of the initial public offering process. The offering prospectus is drafted with great care and receives intense attention because it is the primary disclosure document in the IPO.

The offering prospectus is part of the registration statement and contains a detailed description of the company and its business. It serves multiple purposes. The underwriters and the company use the preliminary prospectus, as it is called until near the end of the process, to market the offering to potential investors. The underwriters will also base the initial investor presentations for the road show on the disclosure in the preliminary prospectus, and the road show presentation must be consistent with the preliminary prospectus. Although the company tells its “story” in the preliminary prospectus, it is also the disclosure document that disgruntled investors may base a securities law claim on if it contains inaccuracies or suffers from misleading omissions.

The company files with the SEC a complete registration statement, which includes the preliminary prospectus but excludes a limited set of information relating to the final offering price per share for the IPO. Typically, the majority of the SEC’s comments on the registration statement will concern aspects of the disclosure in the prospectus.

Drafting the prospectus and the registration statement takes a tremendous and patient effort from the working group, as well as various parties whose input may be required to make the disclosure accurate and complete. Company counsel and management typically collaborate on the initial draft of the registration statement. This initial draft is then distributed to the working group well in advance of the first drafting session, and frequently in advance of the organizational meeting so that members have an opportunity to read, analyze and formulate a response to it. The IPO working group (management, underwriters and counsel) then holds drafting sessions to discuss, and provide comments to, updated drafts of the registration statement. The drafting sessions are usually held weekly in the beginning and then more often toward the end of the process. Revising the registration statement involves a substantial time commitment from members of the working group, who must frequently negotiate language to reconcile the sometimes countervailing goals of accurate, balanced disclosure (legal protection) and wording that will enable the underwriters to successfully convey the company’s compelling attributes to potential investors (marketing).

Once the drafting process is complete, the company files the registration statement with the SEC (an emerging growth company can submit the registration statement on a confidential basis rather than publicly file the registration statement). The SEC reviews the business, legal, accounting and other aspects of the registration statement to determine whether it complies with the applicable disclosure requirements set forth in federal securities laws and regulations. The SEC provides initial written comments to the company approximately 30 days after receiving the registration statement. The working group then discusses proposed responses to the comments and prepares a comment response letter. The registration statement and prospectus typically are amended and refiled to update information and reflect the changes required in response to the SEC’s comments. This comment and response process may go through several iterations before the SEC is satisfied.

Once the revisions are complete, the company is in a position to print copies of the preliminary prospectus contained in the registration statement for use in the marketing road show with potential investors. If the registration statement was previously submitted on a confidential basis, the company must publicly file the registration statement at least 15 days before the road show. When the road show concludes, the company asks the SEC to declare the registration statement “effective” and the underwriters and the company agree on a price at which the company’s stock will be sold to the public. The company adds the pricing information and any other necessary updates to the prospectus (including any changes that may have resulted from the actual offering price varying from the anticipated price set forth in the preliminary prospectus). The resulting document is the final prospectus that the company files with the SEC.

Peek at the Process
“From Pen to Paper to IPO Proceeds”:
An Offering Roadmap

The following outline identifies key steps from the initial drafting of the registration statement through the IPO closing, along with some time estimates (the actual time for these steps can vary widely). The outline below is a summary; many additional steps must be completed in an IPO. Company counsel should provide a thorough, detailed time and responsibility list, setting forth the actions required and parties responsible for their completion from the start to the finish of the process. (See “Appendix 2: Sample IPO Time and Responsibility Schedule.”)

1. Determine whether the company qualifies as an emerging growth company. This will impact, among other things, communications with potential investors, whether the company can submit the registration statement confidentially and whether the company can rely on reduced content in the registration statement.
2. Draft the registration statement, including the preliminary prospectus that describes the company’s business (four to six weeks, meeting at least weekly).

Peek at the Process
“From Pen to Paper to IPO Proceeds”:
An Offering Roadmap (cont’d)

3. File the registration statement with the SEC.
4. Receive written comments to the registration statement from the SEC (approximately 30 days after confidential submission or filing).
5. Respond to the SEC comments through a letter to the SEC and by revising the registration statement where appropriate. Confidentially submit or file the response letter and corresponding amendment to the registration statement with the SEC (5 to 15 days).
6. Receive written comments to the amended registration statement and response letter from the SEC (approximately 5 to 10 days, depending on the initial SEC comments, the company’s response and how busy the SEC is).
7. Respond to the SEC’s second round of comments through a written response letter and a second amendment to the registration statement. Confidentially submit or file this response letter and second amendment with the SEC (3 to 7 days).
8. Complete any additional rounds of comments and responses that may occur. Frequently, at this stage, company counsel talks with the SEC by phone to resolve comments without continuing rounds of amended disclosure and written responses.
9. If the registration statement was previously submitted on a confidential basis, file the registration statement publicly at least 15 days before launching the road show.
10. After resolving major SEC comments, print the preliminary prospectus and launch the road show.

Peek at the Process
“From Pen to Paper to IPO Proceeds”:
An Offering Roadmap (cont’d)

11. At the end of the road show, ask the SEC to declare the registration statement effective. Establish the price of the company’s stock to the public and finalize and file the final prospectus with the SEC.
12. Stock begins trading the day after pricing.
13. Close the IPO (4 trading days after the day of pricing, 3 days after the stock begins trading).

**Source of Disclosure Requirements—Form S-1,
 Regulation S-K and Rule 10b-5**

For most initial public offerings, the company files its registration statement on Form S-1. Form S-1 contains the framework for the registration statement and references the appropriate sections of Regulation S-K (which describes the nonfinancial information the company must provide) and Regulation S-X (which describes the financial information the company must provide, including the financial statements to be included in the registration statement). The JOBS Act and the FAST Act limit some of the information emerging growth companies would otherwise need to provide in their Form S-1, including information about executive compensation and certain historical financial statements. In sum, Form S-1, Regulation S-K, Regulation S-X, the JOBS Act and the FAST Act are the regulations that detail the information the company must include in the IPO registration statement.

But a company’s disclosure obligations do not begin and end there—the disclosure in the registration statement must comply with the basic antifraud tenets of the federal securities laws. These tenets, embodied in Section 10(b) of the Exchange Act and related Rule 10b-5 and certain other sections of the Securities Act and rules of the SEC, establish liability for material misstatements and misleading omissions in the registration statement. While not dictating any particular disclosure content, the potential liability for material misstatements or misleading omissions is an overarching driver of the

quality and content of the information presented in the IPO offering prospectus.

**Breaking Down the Registration Statement
 and Prospectus**

The first part of an IPO registration statement on Form S-1 is the prospectus, which discusses the company’s business and financial condition. The second part of the registration statement contains additional information that is not required to be included in the printed prospectus but is publicly available. The additional information includes details concerning indemnification for securities law liability, expenses of the offering, recent company sales of unregistered securities and certain undertakings by the company required by the SEC.

The “glossy” prospectus will be distributed to potential investors as the primary basis upon which investors will decide whether to buy stock in the IPO. Here is an overview of the main sections of the prospectus.

Cover Page

An emerging growth company must identify itself as an emerging growth company on the cover page.

Prospectus Summary

Near the start of the prospectus is the prospectus summary, also known as the “box” due to the border that typically surrounds this section. The prospectus summary includes a condensed description of the company and its business, the company’s key strategies, financial information and basic information about the offering. Many underwriters consider the summary the most important section of the prospectus because it is the first (and sometimes the only) part of the prospectus potential investors read to determine their interest in the company. Consequently, the company, the underwriters and counsel often labor intensively over the summary’s content and wording to convey accurately the key company information an investor would find important to an investment decision.

Breaking Down the Registration Statement and Prospectus (cont'd)

Risk Factors

Immediately following the prospectus summary are risk factors that identify the company's key risks and challenges, and key risks of investing in the company. This section describes risks specific and unique to the company, as well as risks relating to the company's industry. Carefully drafted risk factors give investors a full picture of the investment profile of a company and can offer the company protection if its stock price declines and stockholders sue, alleging that they were not provided with adequate information about the challenges facing the company and its industry. The SEC frowns upon "boilerplate" risk factors. Risk factors should be tailored to the company's particular circumstances. While some companies bristle at the inclusion of risk factors, or the breadth of the factors covered, investors are used to seeing them as part of an offering prospectus. In the event of stockholder litigation, the benefits of these risk factors typically significantly outweigh concerns over the effect they may have on marketing the IPO.

Although it is tempting, a company should not disclose a risk factor on the one hand and then seek to minimize it on the other hand by including so-called "mitigating" language. For example, in a risk factor about a pending patent infringement lawsuit against the company, mitigating language would be a statement declaring that the company expects to prevail or expects that damages awarded will be immaterial. Mitigating language effectively undercuts the benefit of including the risk factor in the first place and may draw a comment from the SEC in its review of the registration statement.

Selected Financial Data

The prospectus contains a table of selected financial data, which generally includes five fiscal years (two fiscal years for emerging growth companies) of income statement and balance sheet data, along with data for the latest interim period and the corresponding comparative period from the prior fiscal year. Frequently the table will require an explanatory introduction and footnotes.

Breaking Down the Registration Statement and Prospectus (cont'd)

Management's Discussion and Analysis of Financial Conditions and Results Operations

In the Management's Discussion and Analysis, or "MD&A," management provides a discussion of its financial results over its most recent three fiscal years (two fiscal years for emerging growth companies) and any interim period. In addition, management discusses its financial position, including its cash flows and liquidity. The financial result comparison is presented as a narrative comparison of the changes in results on a year-over-year (or period-over-period) basis, typically on a major-line-item basis. MD&A is meant to allow investors to look at the company's financial results through management's eyes—in other words, to help investors understand not just the "numbers," but what management thinks are the causes underlying the company's financial results. MD&A thus focuses on factors underlying changes in results, and known trends, commitments and uncertainties that may reasonably likely have a material effect on the company's financial condition or results. An important goal of the MD&A is to provide potential investors with an ability to analyze whether past performance is indicative of future performance. For instance, if a major portion of revenue comes from a customer that will not repeat the business in the succeeding financial period, that fact should be discussed.

Business

The business section provides a complete picture of the company, frequently including an industry overview, a summary of the business generally and details on the company's products and services, customers and customer relationships, facilities, marketing strategies, intellectual property, research and development and personnel. The business section should present a balanced view of the company. Recall that a prospectus cannot contain any material misstatements or misleading omissions.

Breaking Down the Registration Statement and Prospectus (cont'd)

Management

The “management” section of the prospectus provides biographical information about each of the executive officers and directors. This section also provides substantial information about executive compensation and benefits and transactions with the company. The SEC also requires inclusion of a Compensation Discussion and Analysis section, which focuses on the material principles underlying the company’s executive compensation policies and decisions and the most important factors relevant to analysis of those policies and decisions. The Compensation Discussion and Analysis section provides investors material information necessary to understand the company’s compensation policies and decisions regarding its executive officers. Emerging growth companies can provide more limited information about their compensation arrangements.

Other Information

In addition to the sections of the prospectus highlighted above, the company will have to provide significant information about the company and the offering, including information related to the use of proceeds, major stockholders, related party transactions, dilution, underwriting arrangements and the company’s capital, among others.

Emerging growth companies will also have to disclose details about their status as an emerging growth company.

Financial Statements

The prospectus requires audited financial statements that include three years (two years for emerging growth companies) of income statements and two years of balance sheets, accompanied by the audit report. The company will also have to include unaudited financial statements for any interim financial period required to be included in the registration statement. The financial statements must meet the requirements of GAAP and Regulation S-X. If the company is required to present pro forma information, pro forma financial statements may

Breaking Down the Registration Statement and Prospectus (cont'd)

also be required. Each time the company files with the SEC a registration statement or an amendment to it containing the auditor’s report, the company must obtain the auditors’ consent to the filing. The auditor’s consent is filed as an exhibit to the registration statement.

Graphics

Frequently, the underwriters will want to include “artwork” inside the front, and sometimes back, cover of the glossy prospectus. Typically, this takes the form of pictures or drawings, with the goal of illustrating the company’s products, services or facilities.

Regulation G: Beware of the Use of Non-GAAP-Based Financial Disclosure in the Registration Statement

During the late 1990s, the use of non-GAAP financial disclosure in securities disclosure documents became increasingly prevalent. The SEC became concerned that the use of such non-GAAP financial measures, while supposedly used to provide more meaningful disclosure, was often resulting in inconsistent, confusing or misleading financial disclosure and financial metrics. The SEC adopted Regulation G in response. Regulation G requires primarily uniform, GAAP-based disclosure of financial results and forecasts in securities filings, including IPO registration statements. In those situations where Regulation G permits the use of non-GAAP financial information, it requires additional disclosure to help make that information understandable and meaningful. For example, if permissible non-GAAP disclosure of financial information is included in a registration statement, it must also include:

- A presentation of the most directly comparable GAAP measure as prominently as the non-GAAP measure;
- An understandable reconciliation of the non-GAAP measure to the most comparable GAAP measure;
- An explanation of why management believes the non-GAAP measure provides useful information to investors; and

- Any additional purposes, if material, for which management may use the non-GAAP financial measure.

Exhibits and Confidential Treatment

SEC rules require the company to file certain documents as exhibits to the registration statement, including the company's certificate of incorporation and bylaws, the underwriting agreement, opinions related to the offering, certain debt instruments and "material" contracts.

What constitutes a material contract under the SEC rules is not necessarily intuitive. Determining whether a contract must be filed with the registration statement turns on whether it is made in the ordinary course of business. Contracts made in the ordinary course of business are generally defined as those that ordinarily accompany the kind of business conducted by the company.

Any contract made outside the ordinary course of business that is material must be filed as an exhibit to the registration statement. In this context, the term "material" may refer to either the dollar amount involved or to any other factor that makes the contract a significant one for the company.

If a contract is one made in the ordinary course of business, it does not have to be filed with the registration statement, except in certain situations. The following categories of contracts must be filed, even if made in the "ordinary course," unless they are immaterial in amount or significance:

- Contracts to which a director, officer, security holder named in the registration statement or underwriter is a party;
- Contracts on which the company is substantially dependent;
- Contracts involving the acquisition or sale of any property, plant or equipment for consideration exceeding 15% of the company's fixed assets; and
- Material leases that relate to part of the property described in the registration statement.

In addition, the following management contracts or compensatory arrangements must be filed as exhibits:

- Management contracts or compensatory plans, contracts or arrangements in which any directors or any of the principal executive officer, principal financial officer or three other most highly compensated executive officers participate—unless the compensatory plan, contract or arrangement by its terms is available to all employees, officers or directors and does not discriminate between management and nonmanagement positions regarding allocation of benefits;
- Any other management contract or other compensatory plan, contract or arrangement in which any other executive officer participates unless immaterial in amount or significance; and
- Any compensatory plan, contract or arrangement adopted without stockholder approval that provides for the award of equity or equity rights, such as stock options, unless immaterial in amount or significance.

Any contract filed as an exhibit to the registration statement will be publicly available. However, public disclosure of some information in contracts, particularly competitively sensitive commercial or financial information, could hurt the company. Examples of information that raise concerns for companies include pricing terms, technical specifications or milestone payments contained in material contracts. To address this problem, the SEC will permit confidential treatment to be granted to narrowly tailored parts of material contracts. As the company identifies contracts that must be filed as exhibits, it should consider whether to request the SEC to grant confidential treatment to any portions of the contracts.

A company's request for confidential treatment must set forth its analysis as to why confidential treatment should be granted. The SEC typically grants confidential treatment on only a narrow basis, so a company should specify as narrowly as possible the portions of the contract for which it seeks confidential treatment. The SEC will not grant confidential treatment simply because the company must get consent of the counterparty to disclose a contract's terms publicly. Obtaining confidential treatment can be time-consuming, so the company should file its confidential treatment

request at the time that it initially files its registration statement or soon in the process after the initial filing. A complete contract will need to be submitted to the SEC in addition to a version redacting the information for which confidentiality is sought. If confidential treatment is granted for a contract, the company must refile a confidential request on the contract every three years to maintain confidentiality.

Third-Party Consents

The company may need consents from third parties when it files the IPO registration statement. For example, if the company must file a material contract as an exhibit to the registration statement, and the contract contains confidentiality provisions, the company may need the other party to the contract to consent to its filing.

Consent is also required for the use of any expert's name in the registration statement. This would include the company's auditors with respect to the audit opinion included in the registration statement. It may also include industry experts who provided information or data included in the registration statement. A company does not need these expert third-party consents if it is an emerging growth company filing the registration statement on a confidential basis.

Listing on the Exchange

One critical component of the IPO is the exchange listing process. Having the company's stock listed on an exchange such as the NYSE or one of the Nasdaq markets creates a (hopefully) liquid market in the company's stock. Choosing the market on which the company will list its stock will depend on a number of factors, and a company should consult with its underwriters and counsel to determine which market is the best fit. A company will also have to determine whether it can satisfy the listing requirements of the exchange on which it wants to list. Appendix 3 sets forth a summary of the initial listing requirements for each of the NYSE, the Nasdaq Global Select Market, the Nasdaq Global Market and the Nasdaq Capital Market. Additionally, on a going-forward basis, the exchange rules subject listed companies to extensive corporate governance requirements, which we discuss in greater detail in Chapter 11.

Exchange Act Registration

During the IPO effort, most of the document preparation focuses on the registration statement on Form S-1, which registers the initial offering of common stock to the public under the Securities Act. However, in order for the stock to be traded on an exchange from and after the IPO, the company must also file a registration under the Exchange Act to register the class of security to be listed on the exchange. Registration under the Exchange Act is accomplished by filing a short registration statement on Form 8-A. This form is relatively simple for a company concurrently registering for an IPO. Form 8-A describes the general characteristics of the company's securities being listed, including dividend rights and voting rights, and any anti-takeover provisions in the company's charter documents.

Chapter 7

Publicity and Communications



The federal securities laws regulate the kind of information a company may use to offer stock in its initial public offering and the manner in which the company may provide the information. The regulatory scheme governing communications while in registration is generally designed to ensure that the company conveys information about the IPO primarily through a prospectus meeting the detailed disclosure requirements under applicable SEC rules. The Securities Act, SEC regulations and staff interpretations govern the kinds of communications a company may make leading up to the filing of its registration statement, between the filing and the time the registration statement is declared effective, and after effectiveness. Consequently, the types of communication a company conducting an IPO may make will vary at different stages of the IPO process. Many companies embarking on an initial public offering are surprised to learn that this regulatory scheme limits the kinds of publicity and communications the company may engage in leading up to, during and after the IPO. A company needs to continue business, after all, and most companies need to engage in publicity, marketing and communications to promote their products and services, reach customers and generate sales. In tension with this practical goal is the desire of the SEC to regulate the information provided to potential investors to generate interest in the company's public offering. In its Securities Offering Reform rules in 2005, the SEC took steps to decrease some of the tension between a company's need to communicate information for business purposes and the SEC's regulation of information provided to investors. The "test the waters" provisions of the JOBS Act, enacted in 2012, further relaxed certain restrictions for emerging growth companies, or EGCs.

The Pre-Filing Period—Don't Jump the Gun

Other than "test the waters" activities undertaken by or on behalf of an EGC in compliance with the JOBS Act, neither the company nor an underwriter may make a written or oral offer to sell, or solicit an offer to buy, its securities during the pre-filing period of the IPO. The "pre-filing

period" begins when the company decides to proceed with the offering (i.e., is "in registration") and ends when the company has filed its registration statement. There is no bright line as to when a company is first "in registration" but, at the latest, a company should consider itself in registration once it reaches an understanding with a managing underwriter to lead its public offering.

Because the SEC has broadly interpreted what constitutes a written or oral "offer" to include communications that "condition the public mind or arouse public interest in particular securities," a company's publicity or other business communications during the pre-filing period can inadvertently constitute a prohibited written or oral offer of its stock. For example, the SEC could view company-generated publicity touting the company during the pre-filing period as an illegal offer because its effect is to condition the market to be receptive to the company's stock in the IPO, a problem known as "gun-jumping." The SEC has created a number of safe harbors that help clarify what kinds of business communications before and during an IPO would not be considered illegal "gun-jumping."

Rule 163A provides a safe harbor with respect to company communications more than 30 days before the filing of the registration statement. Company communications made more than 30 days prior to the filing of a registration statement will not violate the gun-jumping provisions of the Securities Act if (1) the communication does not refer to a securities offering that will be covered by a registration statement, (2) the communication is made by or on behalf of the company going public, and (3) the company takes reasonable steps within its control to prevent redistribution or republication of the communication during the 30 days before filing the registration statement.

The first two requirements are straightforward, but what does it mean for a company to take "reasonable steps within its control" to prevent dissemination of the communication during the 30-day pre-filing period? There is no recipe for what actions would constitute reasonable steps, but the SEC did offer some helpful guidance in a few areas:

Website Information. Is a company required to remove all its information from its website 30 days before filing to avoid gun-jumping? The SEC does not expect a pre-IPO company to remove information from its website, but website content should generally consist of ordinary factual business information (e.g., information about products, services and other typical website

content). Press releases, media articles and other hyperlinked third-party content should be appropriately dated or otherwise identified as historical material. Nothing on the website should refer to the offering activities.

Timing of Publication of Interviews. While the SEC does not expect a company to be able to control the republication or accessing of press releases that were issued before the 30-day pre-filing period, it does expect the company to control its own involvement in communications that may be distributed or published during the 30-day period. For example, the SEC has made it clear that a company that gives an interview to the press prior to the 30-day period cannot rely on the Rule 163A safe harbor if it is published during the 30-day period.

PRACTICAL TIPS
“Caution on Communication”:
Keeping Pre-Filing Communications Safe

To make use of the Rule 163A safe harbor on permissible communications more than 30 days prior to filing a registration statement, a company should develop a process with its internal and external communications team several months before the IPO. It should appoint a communications “czar,” an employee who will oversee the company’s communications practices. The communications czar should ensure that leading up to the IPO, the company has authorized all press releases or other corporate communications. This practice will help satisfy the Rule 163A requirement that communications are made “by or on behalf” of the company.

If the company or its representatives give media interviews before the 30-day pre-filing period, the company should take reasonable steps to prevent republication of those interviews during the 30-day pre-filing period. For example, the company could enter into a written agreement with the news or media company not to publish or disseminate the interviews during the period that the company reasonably believes will include the 30-day pre-filing period. The company should make sure that the period covered by the agreement is long enough—sometimes market conditions can cause a company to delay its registration statement filing at the last moment.

Ongoing Communication of “Factual Business Information”

A company needs the flexibility to make ordinary business communications, such as announcing new products or corporate developments, during the 30 days prior to filing and the entire IPO process without constantly being concerned that the communications might constitute market-conditioning rising to the level of an illegal “offer” of securities. Rule 169 provides a safe harbor for ongoing communications “by or on behalf of an issuer” of “factual business information” intended for use by persons receiving the information other than in their capacity as investors or potential investors, such as clients, customers or suppliers. “By or on behalf of an issuer” means that the company, or an agent or representative of the company (other than offering participants like underwriters), authorizes or approves the release of the information. “Factual business information” means:

- Factual information about the company, its business or financial developments or other aspects of its business, and
- Advertisements, or other information, about the company’s products or services.

To rely on the safe harbor, the company must satisfy a few additional conditions:

- The company must have previously regularly released this type of factual business information in the ordinary course of business.
- The timing, manner and form in which the information is released must be consistent in material respects with similar past releases.
- The company must intend that the information be used by persons, such as customers and suppliers, not acting in an investor capacity.
- The information must be released by the company’s employees or agents who have historically released such information.

Peek at the Process
Regularly Released Requirement

There is no minimum time period to satisfy the “regularly released” condition, but the company must have some “track record” of releasing the particular type of information at issue, which can include only once previously. The SEC does warn that releasing a new type of financial information or projection just before or during the offering will likely not pass muster. By the same token, if a company regularly releases information on a periodic basis, such as news about product releases each quarter, it would likely fail to meet this condition if it accelerated the release of such information to a weekly basis on the cusp of its initial public offering. But the SEC has made it clear that the “regularly released” requirement does not apply solely to regularly scheduled releases of information but can include episodic communications, such as product advertising, if the issuer has previously provided such communications in that manner.

There are two important exceptions to the safe harbor of Rule 169. First, it does not apply to information about the IPO or information released as part of the offering activities in the IPO. For example, while the safe harbor may be available for issuance of a press release consistent with past practice, it would not cover the distribution of that press release as part of the marketing activities to potential investors in the IPO. Second, the safe harbor does not apply to forward-looking information.

PRACTICAL TIP
Create a “Track Record”

Don’t wait until the last minute to establish a practice of regularly releasing business information. If a company is contemplating an IPO, it should establish a regular pattern and manner of releasing important business information, such as corporate developments or product updates. If the company waits until shortly before the IPO to do so, it will be difficult to establish that it has regularly released the information and consequently will cast doubt on whether dissemination of these types of information during the IPO process should enjoy the protection of the Rule 169 safe harbor.

Permitted Announcements During the Pre-Filing Period

Rule 135 of the Securities Act provides a limited exception to the restrictions on pre-filing publicity about a company’s IPO. It permits a public announcement of a proposed public offering as long as the announcement is limited to the following information:

- The name of the issuer;
- The title and amount of securities offered;
- The amount of securities to be offered by selling security holders;
- The timing of the offering;
- A brief statement of the manner and the purpose of the offering;
- Whether the offering is being directed only to a particular class of purchasers; and
- Any statements or legends required under state or foreign securities laws or regulations.

The announcement may not identify the underwriters or describe the issuer’s business and must include a legend that states that the announcement does not constitute an offer of any securities for sale. An announcement that

complies with Rule 135 is deemed not to constitute an “offer” for purposes of Section 5 of the Securities Act. Rule 135 announcements are not typically made, particularly for IPOs, and any consideration of whether to make such an announcement should be carefully coordinated with the underwriters for the offering.

Testing the Waters by Emerging Growth Companies

As discussed in Chapter 5, the JOBS Act provides an exemption for emerging growth companies from the “gun-jumping” restrictions described above for written and oral communications with qualified institutional buyers, or QIBs, and other institutional accredited investors. This exemption allows an EGC (and its underwriters) to gauge the interest of QIBs and institutional accredited investors in the IPO—referred to as “testing the waters.” An EGC (or its underwriters) can engage in test-the-waters communications with qualified investors before or after the confidential submission or public filing of the registration statement for the IPO. Testing the waters can assist the underwriters in determining the appropriate price, volume and market demand for a potential IPO and thereby help an EGC evaluate the prospects for a successful IPO before investing the time, energy and cost involved in going public. A company that is interested in testing the waters should engage with its underwriters to explore the pros and cons of engaging in these activities, determine the optimal timing, and discuss the information to be used in test-the-waters meetings (and whether to use written materials).

Test-the-waters communications are subject to the general antifraud provisions of the federal securities laws, and during the comment process the SEC staff will typically inquire whether an EGC has communicated with potential investors pursuant to the test-the-waters exemption and request copies of any written communications. For these reasons, a company planning to take advantage of this exemption should work with its outside counsel, underwriters and underwriters’ counsel to ensure that any test-the-waters communications are materially consistent with the information that will ultimately be included in the IPO registration statement.

The test-the-waters exemption allows for the solicitation of nonbinding indications of interest only. The obligation of a broker-dealer to make available a copy of the preliminary prospectus before soliciting orders and the requirement that a final prospectus be delivered or made available prior to

the sale of securities to an investor contacted through test-the-waters communications continue to apply.

Post-Filing—Written Offering-Related Communications

Prior to the adoption of the Securities Offering Reform rules in 2005, a company had three ways to communicate matters relating to the IPO after filing the registration statement and before the SEC declared it effective (the so-called “waiting period”): (1) the “red-herring” preliminary prospectus (so named for the red legend printed on the cover of the prospectus stating that offers cannot be accepted until the registration statement is effective), (2) a press release or tombstone advertisement that provided very limited information identifying the offering pursuant to Rule 134 of the Securities Act, and (3) road show meetings with potential investors. The Securities Offering Reform rules relaxed the restrictions on written offering-related communications that can be made after the registration statement is filed in two ways. The first was incremental—expansion of the types of information permitted to be included in a press release or similar publications under Rule 134. The second was more radical—the permitted use of “free-writing prospectuses.”

Press Releases and Other Offering Notices

A press release has typically been used by companies to publicly announce the IPO after the registration statement is filed and to tell potential investors from whom a prospectus can be obtained. Rule 134 substantially limits the information a company may include in the release. As a result of the reforms, however, the release may now include more information about the company and its business, the mechanics and anticipated schedule of the IPO, procedures for account opening and for submitting indications of interest and conditional offers to buy the offered securities, and procedures for directed share plans and other participation in the IPO by officers, directors and employees. This notice may be in the form of a press release, an email or a website posting.

Free-Writing Prospectus

The changes regarding the use of “free-writing prospectuses” ushered in by the Securities Offering Reform rules in 2005 are significant for IPOs. Prior to the reforms, once a company filed a registration statement, only one kind of

written offer of the stock was permitted—a prospectus meeting the requirements of the statute (i.e., the preliminary prospectus). The reform rules allow a new kind of written offer to be used post-filing—the free-writing prospectus.

A free-writing prospectus is any written or graphic communication, other than a preliminary prospectus satisfying applicable SEC requirements, that constitutes an offer to sell, or a solicitation of an offer to buy, securities that are the subject of a registration statement. The term “written communication” is broadly defined to include communication that is written, printed or broadcast on television or radio. Graphic communications include communications via any form of electronic media, such as emails, websites and social media.

An IPO company or an underwriter may use a free-writing prospectus only after the registration statement has been filed, and it must be accompanied or preceded by the most recent preliminary prospectus containing a price range. For a free-writing prospectus in electronic form, such as an email, the company can satisfy this requirement by including a hyperlink in the email that links to the most recent preliminary prospectus. A free-writing prospectus may contain information not included in the registration statement, so long as the information does not conflict with anything in the registration statement. Free-writing prospectuses are offers and are therefore subject to liability for material misstatements or material misleading omissions if the person making the offer through the free-writing prospectus cannot sustain a due diligence defense.

A company undertaking an initial public offering is generally required to file with the SEC, on or before the date it is first used,

- A free-writing prospectus prepared by or on behalf of the company, or used or referred to by the company;
- Material information about the company or its securities that has been provided by or on behalf of the company and that is included in a free-writing prospectus prepared by or on behalf of, or used by, any other IPO participant, such as an underwriter; and
- Any part of a free-writing prospectus that describes the IPO’s final terms or the stock offered.

An underwriter is generally required to file a free-writing prospectus if the underwriter distributes it in a manner reasonably designed to lead to broad, unrestricted dissemination, such as posting the free-writing prospectus on an unrestricted website. By contrast, no filing is required if an underwriter posts the free-writing prospectus to a website with access restricted to its customers, or includes it in an email by the underwriter to its customers, regardless of the number of customers.

Updating Website and Consistency With Disclosure

Most companies use their websites to communicate general business, marketing and financial information to customers, the general public and potential investors. A company might also use its website to supply information from third parties, either by publishing the information on its website or by hyperlinking to the third party’s site. Because all online disclosures must comply with federal and state securities laws, they pose legal risks for the company. The SEC has made it clear that information available on a corporate website constitutes a “written communication” subject to the SEC’s antifraud rules.

Trap for the Unwary *“Keep It Clean”: Scrubbing the Website to Avoid Gun-Jumping*

Although a company may think it is acceptable to promote itself and laud corporate developments on its website, the SEC may view website content as an “offer,” a “general solicitation” or even a “nonconforming prospectus.” As a result, a company planning for an IPO should take precautions regarding its online disclosure:

- Carefully review the company website and any information on third-party websites to which it hyperlinks.
- Work with counsel to understand the SEC’s strict rules regarding what kind of information may be disseminated when and to whom, which depend in part on the nature of the content and the timing of its availability before, during and after the registration process.

Trap for the Unwary
“Keep It Clean”: Scrubbing the Website to Avoid
Gun-Jumping (cont’d)

- “Scrub” the website before an offering to possibly remove company or product hype, links to third-party sites and other nonverifiable information.
- Avoid establishing a new website, or launching a new image campaign, immediately before or during the registration period. The SEC may view such efforts as an attempt to condition the public to be receptive to the IPO and therefore as an illegal “offer” before or during the IPO.
- Use the website in a manner consistent with the company’s past practice, for ordinary-course corporate communications (including press releases).
- Do not mention website addresses in the prospectus other than as a statement of fact.
- Limit references, if any, to an offering according to the “tombstone” and related rules of the SEC.

Chapter 8

Kick-Off:
The Organizational Meeting

Prepare, Prepare, Prepare: The Strategic Advantage of
the Over-Prepared Issuer

Once the company has selected the managing underwriters for the offering and wants to begin the IPO process in earnest, the company and managing underwriters will schedule an organizational meeting with management, the underwriters, counsel and possibly the auditors. The meeting’s purpose is to discuss the offering process and economics, the proposed offering schedule, allocation of responsibilities and any potential issues that may be encountered during the offering process. Company management typically gives presentations at the meeting to educate the working group on the company’s business, history and industry. In addition to the business overview, the group will discuss a number of “housekeeping” matters such as due diligence issues. An organizational meeting typically lasts from a half to a full day. The underwriters customarily provide an agenda, working group list and basic offering timeline. The company and its counsel should prepare for the organizational meeting due to the breadth and depth of information presented and discussed.

Agenda for the Organizational Meeting

The underwriters and company should tailor the agenda for an organizational meeting to the particular circumstances of the company and the IPO contemplated. Below are some common items on an organizational meeting agenda:

1. Introduction

- Introductions of the company’s management team and its legal counsel and auditors, and the underwriting group and its legal counsel

2. Structure of Offering

- Size of offering, including amount, primary and secondary shares, and the over-allotment option (a/k/a the “Green Shoe” option)

- Number of shares outstanding and overhang (i.e., shares that will be issuable pursuant to the exercise of options and warrants after completion of offering)
- Recapitalization of company (e.g., stock split or reverse stock split) that might be required prior to offering
- Anticipated use of proceeds
- Selling stockholders, if any
- Lockup agreements
- Distribution objectives and syndication (institutional and retail; domestic and international; directed share program)
- Selection of listing exchange
- Directed share “friends and family” program for employees or others

3. Timetable for Offering

- Drafting and due diligence
- Availability of audited and interim financial statements
- Whether the issuer qualifies as an emerging growth company and, if so, whether to take advantage of the confidential submission process and other benefits available to an EGC in connection with the offering (e.g., provide only two years of audited financial statements)
- Target filing date for Form S-1
- Road show schedule and coverage (e.g., United States only, or United States and Europe)
- Target offering and closing date
- Potential timing conflicts

4. Accounting and Financial Issues

- Presentation of financial statements

- Accounting issues, including any cheap stock charges
- Tax issues

5. Legal, Regulatory and Disclosure Issues

- Pending or anticipated material transactions, including mergers and acquisitions
- Outstanding legal issues, such as current litigation and labor relations
- Anticipated FINRA or blue sky problems and desirability of pre-filing conference with the SEC, blue sky authorities and/or FINRA
- Regulatory issues and any necessary legal opinions
- Related party transactions and insider loans
- Restrictions on publicity and press releases, including company website
- Corporate governance, including board and committee composition and Sarbanes-Oxley compliance
- Arrangements with stockholders, including registration rights
- Circulation of D&O questionnaires

6. Printing the Prospectus and Miscellaneous Topics

- Selection of financial printer
- Discussion of use of color, pictures and logo
- Selection of transfer agent
- Selection of stockholder relations advisor
- D&O insurance

7. Assignment of Responsibilities for Tasks and Next Steps

8. Presentations by Company Management

PRACTICAL TIPS

“Getting Organized for the Organizational Meeting”: Recommended IPO Actions Prior to Organizational Meeting

In addition to preparing to address the items on the meeting agenda, the company should consider taking the following actions to prepare for the organizational meeting:

Twelve Pre-IPO Action Items. Consider the 12 pre-IPO action items discussed in Chapter 3 before the meeting, many of which may be touched upon in an organizational meeting. The organizational meeting process will proceed more crisply, and the underwriters will gain more confidence in the company’s command of the IPO process, if the company identifies the issues and matters on that list and offers a solution or timetable for resolution.

Financial Statements. The company should identify any material accounting or internal control problems to be addressed before the IPO. In addition, the parties will discuss which financial statements should be included in the registration statement. The company should consider the timing and ability to complete work on any interim accounting periods, and what level of auditor review will be required for interim periods.

Management Presentations. Management should prepare summary presentations, which will begin to shape the company’s “story” and guide the drafting of the prospectus.

Initial Draft of Prospectus. The company and its counsel should begin preparation of an initial draft of the prospectus prior to the meeting. The process of drafting the “Business” section of the prospectus will aid the company’s preparation of its management presentations for the organizational meeting. Participants will expect an initial draft of the prospectus soon after the meeting, so starting early will increase the quality of the draft and likely reduce the time required for subsequent group drafting.

Offering Schedule

If nothing else, the organizational meeting attendees will be keenly interested in discussing the offering schedule and responsibility checklist. The underwriters will present at least a high-level offering timeline, with important targets for registration statement filing, road show commencement and offering conclusion. A sample offering schedule and time and responsibility checklist can be found in Appendix 2. This schedule allows for multiple drafting sessions, the underwriters’ completion of their due diligence review, the filing of the registration statement with the SEC, the waiting period for the company to receive its first round of comments from the SEC (approximately 30 days), the revision of the registration statement in response to the SEC’s comments (which may require one or several amendments), the road show presentations, and the pricing and closing of the offering. In some circumstances, the company may want to compress this time period to take advantage of market opportunities, such as favorable news regarding the company’s industry or confidence in the public markets. While the working group may work furiously to accelerate the offering schedule to meet the company’s and underwriters’ optimal offering schedule, SEC review time and resolution of open issues, especially accounting issues, may significantly delay the offering. Companies that are thoroughly prepared will be in the best position to accelerate the process. Chapter 6 also provides an overview of an offering roadmap.

Management Presentations and Discussion of Issues

Presentations by the CEO, CFO and other executive officers about the company are an important aspect of the organizational meeting, and quality, well-prepared presentations can significantly advance the IPO. Be aware that different participants in the process will have varying levels of knowledge about the company and its industry. As a result, the presentations should provide a clear and complete picture of the company. The presentations typically cover the company’s history, its products, services and technology, financial results, the industry and the company’s key strategies and any other information relevant to gaining a solid grasp of the company and its prospects. The goal is to educate the participants about the company and enable them to proceed with reviewing the registration statement and preparing the company for the offering. The discussion of the company’s business at the organizational meeting will also help the underwriters begin to

think through the framework of the company's road show presentations later in the process.

The management team should meet well in advance of the organizational meeting to discuss their presentations so that each member of the team is thoroughly prepared. Typically, the company's CEO presents general information about the company and its industry; the company's CFO presents historical financial information, as well as current projections and relevant accounting issues; and other management team members present information related to their role with the company (for example, the company's vice president of sales presents an overview of the company's sales methodology, customers, targets and trends).

The organizational meeting also presents an opportunity for management and the company's legal counsel and auditors to highlight any potential issues the group may face in completing the offering on the offering schedule. As mentioned above, management should meet with the company's legal counsel and auditors prior to the organizational meeting and discuss potential issues so that any problems can be identified and resolved, or a plan for their resolution prepared. Management should inform the underwriters of any potential issues early in the process to give the offering team plenty of time to solve them effectively. Frank and thorough disclosure of potential issues will also foster a relationship of trust between the company and the underwriters, which is a key component of a successful offering. Disclosure of material issues later in the process could delay, or permanently derail, the offering.

Selecting a Printer

As the company begins drafting the prospectus and orchestrating organizational meeting matters, it should also select a financial printer. The company's financial printer serves multiple functions in an offering. These include not only typesetting and printing but also providing administrative and word processing services, providing document management, hosting meeting spaces for drafting sessions, coordinating the circulation of each registration statement draft, converting the registration statement into EDGAR format and filing the registration statement with the SEC. Using an inexperienced printer, or a printer with inadequate services, can increase offering expenses and contribute to costly delays.

The company should obtain recommendations for a printer from its legal counsel, and the company's legal counsel and the underwriters can assist the company with obtaining bids from those printers. Bids from each printer should be as detailed as possible and include the number of prospectuses to be printed and an estimate of the number of pages for the prospectus, artwork for the prospectus, charges for revisions and distribution, filing fees, conference room fees and related charges (such as food and beverages) and overtime service. It is also advisable for the company to obtain references from each financial printer. When choosing a financial printer, the company should consider using a financial printer with a local office, if possible, to save on travel expenses. However, most of the work with a financial printer is done electronically these days.

Even though the company will choose the printer based, in part, on the bid received from the printer, the final cost for printing services will depend on how often each page is revised, how many amendments have to be filed and whether holiday, weekend, overtime or rush services are required. The bulk of financial printing costs are incurred in the categories of "alterations" and "blacklining." Consider ways to factor these into the bid request to minimize the risk that the actual cost of printing might end up substantially higher than the bid amount. The company can also expect to incur out-of-pocket expenses for postage, freight and other services.

The company's financial printer may provide services after the offering is completed in addition to those provided during the IPO. For example, after the IPO the company will be required to file annual and quarterly reports with the SEC, as well as other periodic reports. Initially, a public company typically uses its financial printer to format and file these periodic reports until it can transition to handling these on its own. Thus, as part of its selection process the company should also consider the potential relationship between the company and its financial printer after completion of the offering.

Chapter 9



Raising the Capital: Underwriting and Distribution

The underwriting and distribution of the company's stock to the public lie at the heart of the initial public offering transaction. This chapter describes the way in which the underwriting and distribution arrangements between the underwriters and the company work.

In an IPO, one or more investment banks will agree to “underwrite” the offering, an arrangement memorialized in the “underwriting agreement.” The agreement typically provides for the underwriters to purchase common stock from the company and effect the distribution and resale of the stock to the public. This process is known as a “firm commitment” underwriting because the underwriters commit to purchase all of the offered stock at a fixed price directly from the company and then resell the stock to the public, either directly or through dealers.

An alternative is a “best efforts” underwriting, sometimes used for higher risk stock offerings. Underwriters in a “best efforts” underwriting agree only to use their best efforts to sell the offered stock to investors on the company's behalf, but the underwriters do not purchase the stock from the company and therefore do not assume the risk for any portion of the offering not sold to the public. Because most IPOs are done on a “firm commitment” basis, this chapter discusses the key considerations and characteristics of a “firm commitment” underwriting and distribution.

Timing the Sale

Underwriters and the company both have an incentive to “time” the initial public offering to maximize the chance of its success. The market cycle for securities of companies in similar industries or with similar businesses can influence the price and success of the offering as much as the strength of the company. The perception that the securities markets are favorable, or even “hot,” for companies in a particular industry or business supports a strong offering with high demand and naturally influences the

company's and underwriters' willingness to invest the time, money and resources for an IPO. Both the underwriters and the company will want to time the offering so that it coincides with a strong or strengthening securities market. The underwriters often push or slow the registration process depending on their view of the market “window” for the company's stock.

Perceptions about market windows customarily have been subject to seasonal fluctuations, too. As a general rule, underwriters shy away from conducting road shows around traditional long holidays, particularly Thanksgiving and Christmas, and the last half of August, when much of Europe and many Americans take vacations. In recent years, however, this resistance appears to have softened, and offerings have been brought to market in these traditional holiday and vacation periods.

More recently, however, other trends have emerged to drive timing of IPO candidates.

Peek at the Process

“Staying Private Longer”: Recent Trends in the Timing of IPO Exits for Venture-Backed Companies

The Emergence of the “Private IPO.” In 2015 the number of \$100 million mega-rounds of private financings more than doubled compared to 2013. Growth rounds have largely replaced traditional IPOs as the preferred financing route for mature startups. The “private IPO” phenomenon has been centered in tech-related companies like Uber, Snapchat and Airbnb, which have far different financing needs than smaller drug and biotech companies.

The Emergence of the Nontraditional Investor. Nontraditional investors, including private equity funds, hedge funds and mutual funds normally focused on the public markets, continue to pour money into firms content to stay in the private markets; the total funding by 2016 tech IPO pipeline companies reached all-time highs at \$182 million in total funding raised on average and \$105 million on a median basis. These figures were up 64% and 42% respectively versus 2015's tech IPO pipeline as many companies on 2015's list stayed private and raised more money.

Peek at the Process

“Staying Private Longer”: Recent Trends in the Timing of IPO Exits for Venture-Backed Companies (cont’d)

Unicorns Rising. Unicorns—a moniker designed to highlight the relatively rare occurrence of billion-dollar startups—have been growing as companies found private equity funding without using the conventional path of a stock market IPO.

Source: The 2016 Tech IPO Report, © 2016 CB Insights. Used by permission.

Amount to Be Raised; Price Per Share

The company, with the advice of the underwriters, will need to determine the total minimum dollar amount it may seek to raise in the IPO before it files the registration statement. This amount can be increased later in the process. It appears on the cover of the registration statement and will be used to calculate the SEC filing fee, which will also include any additional amounts for common stock that the underwriters will have an option to purchase to cover over-allotments (discussed below). Later in the process, the company and underwriters will determine (and file with the SEC) the optimal price range at which the stock will be offered and the number of shares that will be offered. Frequently, the total offering amount, the acceptable amount of dilution to existing stockholders and the target offering price per share are determined, and then the company backs into the right number of shares by considering the company’s proposed valuation and undertaking a stock split or similar recapitalization to achieve that number.

The offering prospectus must also disclose the intended principal uses of the offering proceeds. Underwriters sometimes prefer that the offering proceeds be allocated to particular purposes, e.g., to finance specific items or to repay indebtedness, rather than simply to working capital and other general corporate purposes. Investors presumably view specifically identified intended uses of proceeds more favorably than uses subject to a large degree of management discretion.

Distribution of the Shares

Underwriters have different types of accounts that constitute the primary sources of potential resales of the company’s stock in the IPO. Most investment banks that serve as managing underwriters focus primarily on selling to institutional accounts. Other, often regional, underwriters focus primarily on selling to retail customers. Companies often opt to include both types of underwriters in the underwriting syndicate for the offering so that both institutions and individual investors participate.

The optimal mix of institutional and retail investors is a subject of much debate. Institutional investors typically will hold large blocks of common stock. They are generally considered more sophisticated stockholders than retail investors and better able to comprehend a company’s financial and operational complexities. On the other hand, an institutional investor can more easily influence the market for a company’s common stock through its purchase and sale decisions. Institutional investors also typically take a more activist approach to corporate governance matters. Conversely, retail investors can provide liquidity and stability for a company’s common stock, and sales or purchases by a single retail investor rarely cause market movement in the company’s common stock.

Peek at the Process

“Get the Show on the Road”: Understanding the Road Show

A lot of excitement, a bit of mystery and an expectation of long days usually surround the “road show” for a management team undertaking its first initial public offering. The amount of emotion and focus invested in the road show is warranted, since a well-done road show is critical to a successful IPO.

During the road show, representatives from the company meet with prospective investors, generally institutional investors such as mutual funds, pension funds and the like, in various cities and make presentations about the company.

During the SEC review process, the underwriters and the company will prepare an investor presentation consistent with, and limited to the

Peek at the Process
“Get the Show on the Road”: Understanding the
 Road Show (cont’d)

content of, the disclosure in the prospectus. When the preliminary prospectus is complete, the financial printer will print and deliver the preliminary prospectuses as instructed by the underwriters for ultimate delivery to potential investors. While the prospectuses are being delivered to potential investors and prior to going on the road, the company will meet with the underwriters’ sales forces to educate them on the company and the offering (and hopefully create enthusiasm).

During the road show, the company’s top management will give 20- to 30-minute presentations, followed by 10 to 15 minutes of Q&A, to investor groups or with individual investors one-on-one, usually multiple times a day for two weeks or so, in 10 or more cities in the United States and possibly some cities in Europe. Sometimes, particularly in very large offerings, the underwriters will ask for a second team to give presentations so that more investors can be covered, and may rent a private airplane to better facilitate travel. (Make sure to clarify up front who will pay for that plane.) Increasingly, road show presentations are given electronically so that not all investors are met face to face. The 2005 Securities Offering Reform rules increased certainty and clarified rules about electronic road shows, facilitating electronic road shows to an even greater degree.

The underwriters will introduce the company and may make a few general comments, but otherwise do not participate in the presentation. Only the preliminary prospectus is handed out to potential investors. The slide presentation is not handed out because doing so will make the material a “free-writing prospectus,” subjecting the presentation to a number of SEC rules.

Management’s performance on the road show is one of the most critical aspects of the IPO within the company’s control. It enables investors to assess management up close and personal and gain confidence in the leadership of the company. Heightening the importance of the

Peek at the Process
“Get the Show on the Road”: Understanding the
 Road Show (cont’d)

presentation is the fact that investors often only glance at the prospectus summary prior to attending the presentation. A strong, smooth presentation focused on the key, compelling aspects of the company and industry can make a tremendous difference in investors’ interest in the company. Because of this, the underwriters will strongly encourage “dry runs” of the presentation before the road show. The price per share for the IPO is typically set the day the road show ends, so that the underwriters can capitalize on the momentum of the road show and offering efforts.

The JOBS Act expanded permissible communications during a securities offering by amending the Securities Act to permit an EGC, or any person authorized to act on behalf of an EGC, to “test the waters” by engaging in oral or written communications with potential investors that are QIBs or institutions that are accredited investors to determine whether such investors might have an interest in a contemplated securities offering. Test-the-waters communications may take place before an EGC makes a confidential submission of its IPO registration statement, while the confidential submission is being reviewed, once an issuer has publicly filed, or at any other point in the offering cycle. The objective of this provision was to enable EGCs to gauge investor interest earlier in the process, and, thereby, determine whether to move forward with their offerings. As a result, test-the-waters communications are not considered “offers” and would not be viewed as “gun-jumping.” In the almost three years since the JOBS Act was passed, test-the-waters activities have grown in popularity across all industries and are considered a possibility in almost every deal. The decision whether to test the waters depends on the specific facts of each deal, though issuers in certain industries, such as life sciences, tend to test the waters in nearly every deal.

Selling Stockholders

Existing stockholders may wish, and in fact may have contractual registration rights, to sell shares of company common stock they own in the IPO.

The company and the underwriters should address this issue, which can be quite sensitive, early in the registration process. Some founders and officers may have a substantial portion of their net worth in company stockholdings. Often they have sacrificed for years to build a successful company and understandably may wish to “take some chips off the table” by selling some stock to raise cash. Underwriters may be concerned that allowing stockholders, especially officers or founders, to sell in the IPO may be perceived as insiders “bailing out” because of doubts about the company’s prospects. However, if the company is willing to permit existing stockholders to sell and the underwriters are eager to please both the company and the selling stockholders, and particularly if the market for the issue is “hot,” selling stockholders may be included in the offering, in some cases as the seller of the shares subject to the underwriters’ over-allotment option.

Primary vs. Secondary

“Who’s Selling?”: Information About Selling Stockholders

Tolerance by the market to include selling stockholders in IPOs ebbs and flows. How commonplace are selling stockholders currently in IPOs? We looked at all U.S. IPOs completed in 2015 and found the following:

Percentage of Secondary IPO Shares	Percentage of IPOs Within That Range of Secondary Shares Sold
100%	3.2%
75% - less than 100%	0.0%
Less than 50% - 75%	0.5%
50%	0.0%
25% - less than 50%	2.7%
0% - 25%	7.0%
100% Primary	86.5%

Source: www.IPOVitalSigns.com, © 2016 CCH, a Wolters Kluwer Company. Used by permission.

Participation of selling stockholders in the IPO requires additional offering arrangements. To ensure a smooth process, the selling stockholders will be asked to sign a power of attorney assigning to at least one attorney-in-fact the authority to negotiate and sign the underwriting agreement on behalf of

the selling stockholders. Selling stockholders will also be asked to surrender their stock certificates to a custodian, who will deliver the certificates for transfer at the closing of the offering.

Lockups

Underwriters use “lockup” agreements as a means to help stabilize trading in the company’s common stock following the IPO. Typically, the underwriters will require the company and its directors, officers and stockholders to enter lockup agreements in which they agree not to sell, transfer or otherwise dispose of any common stock they own for a period of time, typically ending 180 days after the closing, without the underwriters’ consent. If the company and underwriters agree to offer a directed share or “friends and family” program (discussed below), officers and directors who participate in the program also will be required to sign a lockup agreement. The underwriters will require that most, if not all, of the lockup agreements be signed before the preliminary prospectus is printed, after which the underwriters’ leverage to obtain the lockups declines. Lockup agreements will contain various exceptions to the prohibition against selling company common stock. With respect to the company, these exceptions typically include:

- The sale of the common stock to the underwriters;
- The issuance of shares upon exercise of outstanding options or warrants; and
- The issuance of options or warrants to purchase shares under the company’s stock incentive plans.

With respect to the company’s directors, officers and stockholders, depending on the circumstances, the lockup exceptions may include:

- Open-market acquisitions of shares;
- Sales pursuant to existing 10b5-1 plans;
- Transfers of shares, or securities convertible into shares, to the underwriters, to limited partners or stockholders of the party subject to the lockup, or as a bona fide gift;

- Transfers to trusts for the benefit of the party subject to the lockup; and
- Transfers by will or laws of descent.

Lockup agreements for non-EGC issuers may provide for an extension of the time period for which transfers are prohibited if the company issues, or announces that it will issue, a release about earnings, or if material news or events relating to the company occur, during a period close to the date that the lockup expires. This period usually is just over 15 days before and just over 15 days after the lockup expiration date. The agreement typically provides that if such a release or material news or event occurs, the lockup period will be extended for a period usually ending at least 15 days after the release or occurrence.

The extension provision, sometimes referred to as a “booster shot” provision, was a reaction to a FINRA rule that was adopted as part of the Global Research Analyst Settlement resulting from the SEC’s lengthy investigation into the role of research analysts in the securities industry beginning in 1999. The SEC’s investigation found that a number of favorable analyst reports on companies that had recently completed an initial public offering had been issued at or near the time the post-offering lockup period expired, presumably boosting the price of the company’s stock at precisely the time that management and others subject to the lockup could begin to sell their shares into the market. The FINRA rule combats these “booster shot” reports by providing that no member of the underwriting group may publish a research report concerning the company whose securities were offered during a period beginning 15 days before and ending 15 days after the expiration or termination of the lockup agreement. A key exception to this prohibition, however, is that a member of the underwriting group may publish a report concerning the effects of significant news or a significant event if that member’s legal or compliance personnel authorize the publication of the report. FINRA repealed these booster shot restrictions for EGCs, as required by the JOBS Act. The restrictions continue for non-EGC IPO issuers.

FINRA also believes that the use of transfer restrictions (lockups) should be consistently and transparently applied to all investors. Accordingly, FINRA rules require that at least two days prior to any waiver or release of any lockup for a director or officer of the issuer, the book-running lead manager

must notify the issuer of the impending release or waiver and announce such release or waiver through a major news service.

Directed Share or “Friends and Family” Programs, and Other Variations

The excitement of an IPO, the potential value of an investment in the company and relationship concerns often lead a company to request that the underwriters reserve a portion, usually no more than 5% to 10%, of the shares to be purchased by the underwriters for sale at the IPO price to the company’s directors, officers, employees, business associates and other interested parties. This type of arrangement is known as a “directed share program.” The program permits “friends and family” of the company to participate as direct purchasers in the offering when they otherwise might not have the opportunity to do so. The underwriters will require direct share program participants to sign lockup agreements and the company to indemnify the underwriters for any liabilities arising out of the program. In addition, detailed disclosure will need to be provided to the SEC about the program. Many underwriters do not care for the additional burden caused by these programs or the reserve of shares they could otherwise allocate, but they usually will accommodate a program if the company has sufficient interest in it.

The Statistics “Going Direct”: Information About Directed Share Programs

Interested in getting shares in the IPO at the IPO price? This can be done by participating in a directed share program, without relying on your broker’s ability to have shares allocated to you. In 2015, however, nearly 62% of IPOs did not have a directed share program. Of the 38% that did, the company most frequently had 5% of the IPO shares allocated to the program.

The Statistics
**“Going Direct”: Information About Directed
 Share Programs (cont’d)**

Percentage of IPO Shares Reserved for Directed Share Program	Percentage of IPOs With That Percentage of Shares Reserved
10.0% or greater	2.2%
7.5 - 10.0%	3.8%
5.0 - 7.5%	3.8%
5.0%	21.1%
2.5 - less than 5.0%	5.9%
Less than 2.5%	1.6%
No Directed Share Program	61.6%

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The Underwriting Agreement

The underwriting agreement sets forth the terms and conditions that govern the underwriters’ purchase of common stock from the company and any selling stockholders, and the rights and obligations of the company, the underwriters and any selling stockholders. Each lead managing underwriter maintains its own form of underwriting agreement. Although the underwriters may seek to have the company and participating selling stockholders sign with few changes, the document as a practical matter is negotiated.

Forms of underwriting agreements are updated periodically to address changes in the law, exchange rules and other concerns. Investment banks have revised their form of underwriting agreement in reaction to the JOBS Act and more recent concerns about potential violations of the Foreign Corrupt Practices Act of 1977 and the Currency and Foreign Transactions Reporting Act of 1970.

The underwriters and the company negotiate the underwriting agreement long before the registration statement becomes effective. Underwriters prefer to have a virtually final form of the agreement completed before printing the preliminary prospectus, with only pricing information to be filled in later.

The company files this final form of underwriting agreement as an exhibit to the registration statement, usually by amendment. After the SEC declares the registration statement effective, the company and the underwriters will (it is hoped) agree on pricing terms and then finalize and sign the underwriting agreement.

Purchase and Sale of Shares—Basics and the “Green Shoe”

The underwriting agreement sets forth the price at which the underwriters agree to purchase the company’s or any selling stockholders’ common stock. The pricing terms, which are negotiated after the underwriters have built the “book” in the course of the road show, provide that the underwriters will pay a price per share that reflects a discount to the price at which the underwriters will offer the shares to the public. The purchase terms provide that the company or selling stockholders, if any, will agree to sell an additional number of shares to the underwriter, typically an amount equal to 15% of the total number of original shares to be sold in the offering, on the exact same terms, to permit the underwriters to cover resales they make in excess of the number of original shares. This option, commonly called the “over-allotment option” or the “Green Shoe” (after the practice putatively pioneered by The Green Shoe Manufacturing Company (now Stride Rite Corporation)), usually expires 30 days after the date of the underwriting agreement.

Underwriting agreements may also provide for online and international offers. Online offers generally permit a paperless transaction. The company and its counsel should clearly understand whether and how these types of offers will be conducted.

The Statistics
“Paying the Piper”: The Underwriters’ Discount

The underwriters of the IPO get paid by buying the company’s stock from the company at a discount, then selling the stock to the public at a higher price. The front page of the prospectus will list the “price to the public” (the price at which the underwriters will sell the stock to the public) and the amount of the underwriters’ discount, which is generally, but not always, 7%. The table below shows a breakdown of the

The Statistics

“Paying the Piper”: The Underwriters’ Discount (cont’d)

underwriters’ discount in IPOs completed in 2015. (The table excludes one IPO with a discount below 2%.)

The standard of a 7% underwriters’ discount, however, might be more pervasive for operating companies going public than the table below suggests. For instance, some specialty or niche issuers, such as certain oil and gas issuers, have a lower standard discount. In addition, discounts may be lower for “blank check” companies, or special purpose acquisition companies (“SPACs”). 2015 saw a flurry of blank check company IPOs. The trend represents an alternative way for asset managers to invest and deploy capital while giving investors a low-risk way to search for strong returns. Blank check companies are formed for the purpose of acquiring other businesses or assets in the future. Unlike a typical company going public, blank check companies have no operating history or material financial results at the time of the IPO. Because blank check companies are essentially “empty vessels,” the disclosure and due diligence burdens, and attendant risks of material misstatements or omission, and the underwriters’ role in shaping the “story,” are significantly diminished compared to traditional IPOs. The diminished burdens and risks might be reflected in a smaller payment, on a percentage basis, to the underwriters.

IPO Discount	Number of IPOs	Percent of IPOs
7+ to 8%	6	3.2%
7%	110	59.5%
6+ to 6.9%	19	10.3%
5+ to 6%	36	19.5%
4+ to 5%	5	2.7%
3+ to 4%	4	2.2%
2+ to 3%	4	2.2%
Average		6.5%
Median		7.0%

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Representations and Warranties

The underwriting agreement contains a number of company representations and warranties. These representations and warranties address customary corporate governance matters and more offering-specific concerns, particularly the accuracy and sufficiency of the registration statement and the other items noted above. If selling stockholders are participating in the offering, they will make various representations and warranties concerning title to, and the ability to sell, their shares.

Covenants

In addition to agreeing to sell shares to the underwriters, the company agrees in the underwriting agreement to comply with federal and state securities laws and exchange rules before and after the sale of the shares. The company also agrees to the lockup terms described above and terms addressing the use of free-writing prospectuses. In addition, and somewhat painfully, the company typically agrees to pay virtually all fees and expenses associated with the offering, except for specified underwriters’ costs and expenses (including legal fees), which the company will nonetheless be obligated to pay if the offering fails to close for any reason other than underwriter default and limited other exceptions.

Closing Conditions

Under the underwriting agreement, the underwriters typically are not obligated to close the sale of the shares until:

- The registration statement has been declared effective;
- Legal opinions have been delivered by the underwriters’ counsel and counsel for the company and any selling stockholders;
- The company’s independent auditors deliver a “comfort” letter on the date the underwriting agreement is signed and as of the closing; and
- The company has certified the continuing accuracy of its representations, warranties and covenants, particularly those concerning compliance with securities laws and exchange rules, made in the underwriting agreement.

The underwriters also typically are not required to close the IPO if the company has suffered any materially adverse change. In addition, the underwriters' obligation to close typically terminates without penalty, pursuant to underwriting agreement provisions referred to as the "market-out" provisions, if events like the following occur before closing:

- Trading in securities on the major U.S. exchanges has been suspended;
- A general moratorium or material disruption in U.S. commercial banking or securities settlement activities has occurred; or
- War has been declared by the United States, hostilities involving the United States have broken out or escalated, or any other calamity has occurred, and the underwriters determine, in their judgment, that proceeding with the offering would be "impracticable or inadvisable."

Although these conditions are remote, there have been instances when the market-out provisions have been exercised permitting the underwriters to cancel closing after pricing an offering, so underwriters staunchly resist any attempt to eliminate any of them from the agreement.

Indemnifying the Underwriters

In the underwriting agreement, the company typically agrees to indemnify the underwriters for all damages the underwriters may suffer as a result of any material misstatement or omission in the registration statement or prospectus. One narrow exception to this obligation is for material misstatements or omissions based on information provided by the underwriters, for which the underwriters will indemnify the company for any resulting damages. Any selling stockholder will also provide indemnification based on material misstatements or omissions of the stockholder. The underwriters' and the selling stockholders' liability for indemnification to others often is capped at the underwriters' discount, in the case of the underwriters, and the net proceeds resulting from the sale of the selling stockholders' shares, in the case of the selling stockholders. The broad indemnification obligations of the company represent a significant allocation of risk to the company and reinforce the importance of thorough due diligence and careful review of each offering document before it is used in the IPO.

Underwriter Default

If an underwriter that is part of the underwriting syndicate defaults on its obligation to purchase shares it had agreed to purchase in the IPO, the underwriting agreement typically gives the managing underwriter a short period of time (usually 36 hours) to either agree to fill in or find a replacement for the defaulting underwriter. If the managing underwriter does not agree to step in for the defaulting underwriter or is unsuccessful in finding a replacement, the company generally has an additional short period of time (again, usually 36 hours) to find one or more new purchasers. If the managing underwriter steps up to the plate, or replacement underwriters are located, then the closing of the offering may be delayed for a short time (usually up to seven days) to make the necessary changes to the offering documents. If the necessary arrangements are made and more than a small number of shares (around 10%) remain unsold, however, the underwriting agreement typically terminates.

Peek at the Process *"Going Dutch": The Use of Dutch Auctions*

The "Dutch auction" is an innovation used in a small number of IPOs, including the Google IPO. In a Dutch auction, the underwriter manages a bidding process for the shares to be resold to investors. A potential investor submits a bid that includes the number of shares the investor is willing to purchase and the per share price the investor is willing to pay for the offered shares. The auction ends after the registration statement is declared effective. The underwriter then determines the highest bid price, the "clearing price," that will sell all the shares in the offering based on bids received at or above that price. The company and the underwriter then agree whether to sell the shares at the clearing price or a lower price. If the public offering price is lower than the clearing price, and thus the offering is oversubscribed, the underwriter allocates the shares on a pro rata basis.

Chapter 10



Price, Close and Trade

Conclusion of the Road Show and Effectiveness of the Registration Statement

The initial public offering process culminates in the company's stock trading on the stock exchange on which the stock is listed. Before the company and the underwriters can agree on the price at which the stock will be offered to the public, the offering participants must work in coordination to complete the SEC review process, FINRA's review of the underwriting arrangements and the stock exchange's review of the company's listing application. The goal is to make sure that these processes conclude before or during the wind-down of the road show. The company and the underwriters work hard to build interest during the road show and hope to price the offering as soon as the road show is completed in order to take advantage of the interest generated.

Events Leading to Pricing

The SEC must declare the company's registration statement effective in order for pricing and trading to occur. Generally, on the day the road show concludes, the company and the managing underwriters ask the SEC to declare the registration statement effective and, once effective, the company sets the price for the IPO.

The SEC's rules require the company and managing underwriters to request in writing that the SEC declare the registration statement effective at least 48 hours in advance of the desired effective time. In addition, FINRA must confirm that it has no objection to the underwriting arrangements before the SEC will declare the registration statement effective. If acceleration is requested at least 48 hours in advance, and the company has addressed the SEC's comments on the registration statement to the SEC's satisfaction, the SEC is generally willing to accommodate the requested effective time. Effectiveness orders, the official SEC document declaring the registration statement effective, are posted on the SEC's EDGAR website. The company's

registration statement under the Exchange Act—typically a short-form registration statement Form 8-A in the case of an IPO—will become effective at the same time as the Securities Act registration statement.

Peek at the Process “Book It”: Building the Book

The level of interest in the IPO that potential investors indicate to the underwriters is perhaps the most fundamental factor affecting the price at which the shares are offered to the public. “Building the book” is a common phrase used to describe the underwriters' process of obtaining indications of interest, and specific price and quantity information, from potential investors. During the road show, as management makes presentations to spur interest in the IPO, the underwriters' sales desks or syndicate groups call potential investors to gauge interest in the offering. The underwriters record the number of shares each investor would be willing to purchase and the potential price the investor would be willing to pay. Recall that no sales may be made at this point, because the registration statement is not effective before the end of the road show. At the road show's conclusion, the underwriters understand the level of investor demand for the offering and, therefore, the number of shares that can be sold (including, potentially, the over-allotment option) and at what price. This information, along with the underwriters' view of current market, industry and economic conditions and developments, shapes the underwriters' recommendation to the company's pricing committee on the “pricing call” of the price per share to the public that the company should select for its IPO.

The underwriters may not actually sell stock during the book-building process. If stock market or industry conditions deteriorate, or jarring events occur at the company or affect the broader economy, even a book that had been strong may fall apart. As a result, underwriters try to minimize the time between the end of the road show and pricing and having the registration statement declared effective. Once the registration statement becomes effective on the date of pricing and the prospectus is completed, the underwriters may confirm the “orders,” committing the investors to purchase the stock from the underwriters.

What Is Pricing and What Happens

IPOs usually are priced after the stock markets close, and the stock begins trading on the next day. Pricing ideally occurs on the last day of the road show while interest in the offering is strong. A “bring-down” due diligence call is held prior to pricing to ensure that all of the information in the preliminary prospectus is still accurate and complete. After the registration statement has been declared effective, the underwriters and the company, represented by senior management, and a pricing committee of the company’s board of directors, frequently made up of the CEO and one or two outside directors, confer by telephone to determine the price at which the stock will be offered to the public. If stockholders are selling in the IPO, a representative of the selling stockholders may sometimes also participate in the pricing call.

The underwriters on the pricing call present their recommendation regarding the price at which they believe the offering should be priced and provide data and other information to support that recommendation, including the “book” of indicated interest, recent performance of the stock markets, performance of recent IPOs and other matters. When an agreement is reached on the price of the stock, the pricing committee formally approves the number of shares to be sold by the company to the underwriters, the public offering price for the shares, and the price to be paid by the underwriters (which is a function of the underwriting discount). The pricing committee also approves the underwriting agreement and reserves the shares for issuance. The company’s auditors will then deliver a comfort letter to the underwriters, confirming the company’s audited financial statements and other financial information in the prospectus. Once these steps have been taken, the underwriting agreement will be signed.

After pricing, the company typically issues a press release announcing the terms of the offering. This release usually consists of basic information about the offering that complies with the SEC’s requirements under Rule 134 so that it does not need to be filed as a “free-writing prospectus.” Chapter 7 discusses Rule 134 and free-writing prospectuses in more detail. The parties will also prepare a final prospectus—which includes the pricing-related information (i.e., number of shares, public offering price, underwriting discount and commissions and net proceeds) and final information about the composition of the underwriting syndicate. The final prospectus must be filed with the SEC within two days of pricing or its first use.

Peek at the Process *“Time to Price”: Overview of the Pricing Schedule*

Below is a schedule of pricing-related events for a typical initial public offering:

- Two days before the expected completion of the road show and pricing → confirm no remaining issues, and file acceleration request, with the SEC
- Two days before the expected completion of the road show and pricing → Confirm SEC obtained FINRA no objection letter and stock exchange authorized listing
- Morning of pricing day → hold “bring-down” due diligence call
- Afternoon of pricing day → SEC declares registration statement effective
- After market on pricing day → hold pricing call and price offering
- After pricing → auditor delivers comfort letter, and the company and managing underwriters execute the underwriting agreement
- Night of pricing day or pre-market the next day → complete the final prospectus and issue press release
- Day after pricing → stock trades
- Fourth trading day after pricing → close initial public offering and receive proceeds from the underwriters

Upsizing the Offering

The SEC’s rules provide a simple mechanism for “upsizing” an initial public offering if the demand for IPO shares exceeds the number of shares initially registered with the SEC. Under the SEC’s Rule 462(b), a short-form registration statement can be filed immediately after the effectiveness of the original registration statement to register up to 20% more stock for offering in the IPO. This “462(b) registration statement” merely registers the additional securities and incorporates them into the original registration statement. It is effective immediately when filed. Registration statements filed under Rule 462(b) are subject to the same requirements with respect to opinions and auditors’ consents, so new opinions and consents will need to be prepared and filed with the 462(b) registration statement. The Rule 462(b) process is a quick, handy way of increasing the size of the offering (up to the 20% maximum) without having to go through a formal SEC clearing or amendment process.

Peek at the Process

“Finally, Paperless”: Access Equals Delivery of the Final Prospectus

Prior to the SEC’s adoption of the Securities Offering Reform rules in 2005, a company completing its initial public offering would print a large number of hard copies of the final prospectus. The final prospectuses were then delivered to all purchasers of the company’s stock in the initial public offering. Recognizing that this was largely a legal formality, and that the investment decision was previously made based on the preliminary prospectus, the SEC adopted Securities Offering Reform rules in 2005 that, among other things, implemented the “access equals delivery” rule. As a result, issuers and their underwriters are no longer required to deliver hard copies of the final prospectus unless requested, so long as the company has filed the final prospectus with the SEC, and it is publicly available “electronically” via EDGAR.

Closing and Closing Documents

Although a company’s stock usually begins trading the day after the IPO is priced, closing does not occur until a few days after trading commences. Assuming that pricing occurs on the trading day immediately preceding the day on which trading actually begins, the closing of the offering typically takes place on the fourth trading day after pricing. At the closing, the underwriters pay for the shares they have purchased to resell to the public, and the shares are delivered by the company’s transfer agent to the underwriters. With modern securities transfer procedures, shares are not physically delivered by the company’s transfer agent to the underwriters; instead they are registered electronically on the books of The Depository Trust Company, a clearing agency for the securities industry.

Prior to closing, the company’s counsel and underwriters’ counsel prepare various closing documents, including officers’ certificates, legal opinions and cross-receipts, for execution and delivery at the closing. Underwriters’ counsel typically prepares a checklist—or closing memorandum—ahead of time to make sure that none of the documents to be delivered at closing or other steps to be taken at or prior to closing fall through the cracks. The offering participants do another “bring down” due diligence call prior to closing, and company counsel confirms with the SEC that no “stop orders” are in effect with respect to the registration statement.

At closing, the company’s counsel delivers a legal opinion to the underwriters regarding the legality of the securities offered in the offering to the underwriters, as well as certain corporate matters including the due authorization, execution and delivery of the underwriting agreement. In addition, the company’s counsel renders a “cold comfort” opinion regarding the completeness of the registration statement and prospectus. If the offering includes shares from selling stockholders, counsel to the selling stockholders also delivers a legal opinion regarding certain legal matters relating to the selling stockholders. The company’s auditors provide a “bring-down” comfort letter dated as of the closing to reaffirm the comfort letter delivered at the time the underwriting agreement was executed and to update it, if necessary, regarding any developments that may have occurred between that time and the actual closing. At closing, the company’s management delivers executed certificates confirming the accuracy and completeness of the registration statement and the representations and warranties in the underwriting

agreement. The delivery of IPO proceeds is confirmed, and the company's counsel coordinates the release of shares by the transfer agent.

Exercise of Over-Allotment Option

If the underwriters choose to exercise their over-allotment option (discussed in Chapter 9), a second closing is typically required to settle the sale of the additional shares. The mechanics, as well as the closing deliveries, for the second closing are similar to those for the first closing. In the case of IPOs for which high demand exists, the underwriters may exercise the over-allotment option immediately after pricing, in which case closing of the over-allotment occurs at the same time as the main offering.

Post-IPO Reporting and Compliance Responsibilities

Once the IPO is completed, the company becomes subject to public reporting and other requirements under the Exchange Act. Among other things, each year the company must file an annual report on Form 10-K, quarterly reports on Form 10-Q for the first three fiscal quarters, and current reports on Form 8-K with respect to a wide variety of "triggering events," including disclosure of material financial information about a completed fiscal period (i.e., earnings releases), significant acquisitions or dispositions, entry into material contracts, resignations of directors and certain executive officers, and creation of financial obligations. In addition, the company will be subject to the SEC's proxy rules that govern proxy statements used to solicit proxies in connection with annual and special stockholders' meetings and related matters. The company's directors, executive officers and greater than 10% stockholders will also have new obligations—they must report their beneficial ownership of the company's stock, as well as changes in such beneficial ownership, under the Exchange Act Section 16 rules. Pre-IPO stockholders who beneficially own more than 5% of the company's stock must report such holdings under the Exchange Act Section 13(d) rules, typically on a Schedule 13G.

Chapter 11 provides a more detailed overview of the post-IPO reporting and compliance responsibilities of a public company and its officers, directors and significant stockholders.

Trap for the Unwary *"Whither the Money?": Don't Forget to Report Use of IPO Proceeds in 10-Ks and 10-Qs*

After the company completes its initial public offering, each post-IPO annual report on Form 10-K and quarterly report on Form 10-Q will need to describe the use of the proceeds the company received in the IPO. The company must make this disclosure in these reports until it has disclosed how all the proceeds have been applied. For some companies, this may take several years or more.

Chapter 11



So Now You Are Public: Navigating the New Environment

Private companies emerge from their initial public offerings with access to all of the benefits of public company life, but those benefits come with obligations. Private companies also emerge from their IPOs in the intense spotlight of public company life—their new responsibilities to their public stockholders and the various constituencies (the SEC, NYSE, Nasdaq and stockholder representatives) that demand robust governance and transparency regarding the company’s business and financial condition. This chapter provides a practical overview of public company corporate governance and disclosure requirements.

Maintaining a Public Company Boardroom

Chapter 4 provides details on assembling an independent board of directors. A majority of a public company’s directors must be “independent”—individuals who can exercise judgment as a director independent of the influence of company management and meet the standards required by SEC and stock exchange rules.

One exception to the majority independence requirement is if the public company is a “controlled company”—that is, a company that has more than 50% of its outstanding voting power for the election of directors held by an individual, group or another company. In a company with super voting stock along with regular common stock—a dual class structure that has become increasingly common with IPOs over the last decade—control may be held by founders or other pre-IPO investors with high-voting stock even though their stake represents a minority economic interest after the IPO.

The SEC and stock exchanges prescribe independence standards, as explained in Chapter 4. In addition to independence, a well-functioning board has the following:

- *Board Leadership.* Board leadership rests primarily with the chair and, if appropriate, a lead independent director. In response to scrutiny from public stockholders and at the suggestion of proxy advisors such as ISS, boards generally either designate an independent director as chair or ask an independent director to share board leadership with an internal chair/CEO (often referred to as the lead independent director).
- *Executive Sessions.* Both NYSE and Nasdaq require nonmanagement and independent directors to meet in executive sessions—meetings without management or other nonindependent directors present. For NYSE companies, executive sessions of nonmanagement directors must be held “regularly” and independent directors (if different) must meet in executive session at least once per year. For Nasdaq companies, independent directors must meet in executive session at least twice a year. Most companies adopt a practice of routinely holding executive sessions of independent directors at each board meeting. An ideal format is to schedule an executive session as the final agenda item at each regularly scheduled board meeting.

Board Committees: Requirements Generally and Under NYSE and Nasdaq

With limited exceptions, listed public companies need to have the following independent board committees:

- Audit Committee;
- Compensation Committee; and
- Nominating and Governance Committee (for Nasdaq companies, director nominations can either be made, or recommended to the full board, by a majority vote of the independent directors or by a nominations committee composed solely of independent directors).

A newly public company should also consider additional committees that may be appropriate given the company's industry. For instance, many financial institutions have a risk management or similar committee. Controlled companies are not subject to the requirements relating to compensation and nominating committees (or, in the case of Nasdaq companies, independent director oversight of director nominations).

Phase-In of Committee Independence Requirements

A newly public NYSE or Nasdaq company will be allowed to phase in its independent core board committees over a 12-month period, with the following limitations:

- One member of each core board committee (Audit, Compensation and Nominating and Governance) must be independent generally at the completion of the IPO process;
- A majority of the members of the core board committees must be independent within 90 days of listing; and
- All members of the core board committees must be independent within one year of listing.

Committee Details and Responsibilities

Audit Committee

Purpose and Authority. The Audit Committee fulfills the board's oversight responsibilities related to the company's internal control, financial reporting and audit functions. The Audit Committee is directly responsible for the appointment, compensation and oversight of the company's outside auditor.

Duties. An Audit Committee typically has at least four areas of responsibility, which it defines in a publicly available written charter:

- Engagement, compensation and assessment of the independent auditor;
- Review of financial statements and oversight of financial reporting;
- Oversight of internal controls and disclosure practices; and

- Oversight of a whistleblower process.

Within these general areas of responsibility, an Audit Committee may work on a wide range of topics, including oversight of risk, internal investigations, cybersecurity and compliance with constantly evolving audit and financial reporting standards. NYSE rules also require the audit committee to oversee legal and regulatory compliance and the company's internal audit function.

Composition and Independence. NYSE and Nasdaq require that the Audit Committee consist of at least three members. With a few exceptions, all members of the Committee must be independent under the relevant stock exchange's independence definition and financially literate. Audit Committee members must also meet heightened independence standards established by Sarbanes-Oxley and incorporated into the NYSE and Nasdaq rules relating to Audit Committee composition. The critical issue is independence from management of the company. Sarbanes-Oxley (and implementing SEC rules) have only two criteria for Audit Committee independence: (1) an Audit Committee member may not receive any compensation other than for board or committee service, and (2) an Audit Committee member may not be an affiliated person of the company.

Financial Literacy. Audit Committee members must be able to read and understand fundamental financial statements, including balance sheets and cash flow statements.

SEC Audit Committee Financial Expert. SEC rules require that a public company disclose the names of one or more members of the Audit Committee who qualify as "audit committee financial experts." If a company does not have an audit committee financial expert, it must disclose why it does not.

NYSE and Nasdaq Financial Expertise Requirements. NYSE and Nasdaq rules require that the Audit Committee have a member with accounting and financial management expertise (NYSE) or employment experience or other comparable experience resulting in financial sophistication (Nasdaq). A director who meets the audit committee financial expert requirements under SEC rules is presumed to satisfy the NYSE and the Nasdaq requirements.

Compensation Committee

Purpose and Authority. A Compensation Committee develops criteria and goals for, and then reviews and approves, the compensation of the company’s senior management.

Duties. The Compensation Committee will typically have the following duties as set forth in a written charter:

- Set goals and objectives relevant to compensation of the CEO and other executive officers;
- Evaluate the CEO’s performance and determine his or her compensation;
- Oversee any compensation consultant or other advisor retained to advise the committee;
- Establish compensation programs for non-employee directors;
- Establish and oversee equity and benefit plans; and
- Recommend stock plan approval.

Composition and Independence. NYSE and Nasdaq require a Compensation Committee of all independent directors—at least three for NYSE companies and at least two for Nasdaq companies. Compensation Committee members must also meet heightened independence requirements under NYSE and Nasdaq rules, as dictated by the Dodd-Frank Act (with an exception for Nasdaq companies allowing a Compensation Committee with at least three members to include one member who does not meet the independence requirements under “exceptional and limited circumstances”). These additional independence rules require the board to consider all factors relevant to determining whether a director has a relationship that is material to the director’s ability to be independent from management in connection with Compensation Committee duties, including (1) the source of compensation of the director and (2) whether the director is affiliated with the company or any subsidiary or affiliate of a subsidiary.

Nominating and Governance Committee

Purpose and Authority. The Nominating and Governance Committee takes the lead in selecting directors, committee members and chairs or lead directors.

Duties. The Nominating and Governance Committee will set forth these duties in a written charter:

- Select the director slate (or recommend the slate to the full board);
- Oversee board governance;
- Develop meeting procedures; and
- Evaluate the effectiveness of board.

Composition and Independence. NYSE requires a Nominating and Governance Committee of all independent directors (at least three), and Nasdaq requires either a Nominating and Governance Committee of exclusively independent directors (with an exception for one non-independent member under “exceptional and limited circumstances” if the committee has at least three members) or that director nominees be selected, or recommended to the full board for selection, by a majority vote of independent directors.

Key Public Company Governance Policies

A fundamental aspect of a public company’s good governance framework is the adoption and public disclosure of its key corporate governance policies. At a minimum, a public company will need the following:

- Corporate Governance Guidelines (NYSE);
- Code of Business Conduct and Ethics; and
- Whistleblower Procedures.

In addition, most public companies will have one or more additional policies, including:

- Public Disclosure / Communication with Analysts;

- Insider Trading;
- Conflict Minerals (if applicable); and
- Related Person Transactions.

Further details on these topics are discussed in the following section.

Corporate Governance Guidelines (NYSE)

The “Corporate Governance Guidelines” required of each NYSE company allow the board and senior management to publicly set out the key tenets of their company’s governance values. Prominently featured on the “Corporate Governance” page of NYSE companies’ websites, the guidelines should address, at a minimum, (1) director independence standards, (2) director responsibilities, (3) director access to management and independent advisors, (4) director compensation, (5) director orientation and continuing education, (6) management succession, and (7) annual self-evaluation of the board. Many Nasdaq companies also opt to adopt corporate governance guidelines as a best practice, and policies of certain institutional investors and proxy advisors encourage such adoption. Governance guidelines often become a repository for board policies on current governance topics that receive attention from investors and proxy advisors, including board leadership structure, director tenure, service on other boards, director stock ownership guidelines, and board confidentiality.

Code of Business Conduct and Ethics

NYSE and Nasdaq require a public company to adopt and post on its website a practical set of ethical requirements for its officers, directors and employees (referred to as a code of business conduct and ethics under NYSE rules and a code of conduct under Nasdaq rules). At a minimum, the code will address:

- Conflicts of interest, corporate opportunities and fair dealing;
- Confidentiality and protection and proper use of company assets;
- Compliance with laws, rules and regulations; and

- Proactive reporting of any illegal or unethical behavior (with protections against retaliation).

NYSE Rule 303A.10 specifies other topics that must be covered by the code. The code of conduct required by Nasdaq must comply with the “code of ethics” from Section 406 of Sarbanes-Oxley. Item 406 of SEC Regulation S-K requires disclosure of a company’s “code of ethics” for its CEO and senior financial officers, and if no such code exists, the company must disclose why it does not.

Whistleblower Procedures

Exchange Act Rule 10A-3 adopted under Sarbanes-Oxley requires an Audit Committee to establish “whistleblower” procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters. Although public disclosure of the procedures is not required, “best practices” suggest at least disseminating the portions of the procedures that describe how to submit complaints. A company’s website and employee intranet are logical places where this information could be made available.

PRACTICAL TIPS

“Transparency in the Internet Age”: Required Website Postings of SEC and Corporate Governance Materials

SEC rules and regulations require website posting of periodic and current reports, proxy materials, financial statements in interactive data format, Section 16 reports and other information. Most public companies have an “Investor Relations,” “Investor Information” or similarly named link on their website.

The following may be a helpful checklist of materials that must be posted:

- Periodic and current reports (Forms 10-K, 10-Q, 8-K), which may be by hyperlinks to SEC website or third-party service providers

PRACTICAL TIPS***“Transparency in the Internet Age”: Required Website Postings of SEC and Corporate Governance Materials (cont’d)***

- Proxy materials, which may be by hyperlinks to SEC website or third-party service providers
- Financial statements, footnotes and schedules in an interactive data format, which are included as exhibits to Forms 10-K, 10-Q and certain other filings (required to be posted by the end of the day on the earlier of the date it is filed or required to be filed with the SEC)
- Section 16 “Insider” Reports (Forms 3, 4 and 5), which may be by hyperlinks to SEC website or third-party service providers (required to be posted by the end of the business day after the date the report is filed with the SEC)
- Audit, Compensation and Nominating and Governance Committee Charters (Nasdaq companies are not technically required to post these; however, if they are not posted, the company would be required to include the charters with the company’s proxy statement at least once every three years)
- Corporate Governance Guidelines (NYSE only)
- Code of Conduct

Public Company Reporting and Disclosure

A public company must comply with extensive ongoing disclosure requirements. Under SEC, NYSE or Nasdaq rules, a public company will make certain mandatory disclosures throughout the fiscal year. Voluntary disclosure, however, is also an important method in communicating the state of the business to the public.

Periodic and Current Reporting

A public company files annual, quarterly and current reports with the SEC. The reports regularly update and supplement information that the company has made available to the public in its IPO and other registration statements and SEC filings. Companies file the reports within a specified number of days after the end of each reporting period or after certain material events. The following are the basic reports and their due dates:

Report	Due Dates for New Public Companies	Due Dates After Transition Period for New Public Companies*
Annual Report on Form 10-K	90 days after the end of the 1st fiscal year in which the company completes its IPO	60 days after fiscal year end for large accelerated filers (public float of at least \$700 million) 75 days after fiscal year end for accelerated filers (public float of at least \$75 million but less than \$700 million) 90 days after fiscal year end for non-accelerated filers (public float of less than \$75 million)
Quarterly Report on Form 10-Q	45 days after the end of each fiscal quarter, until the company has been subject to SEC reporting for at least 12 calendar months and filed at least one Form 10-K	40 days after quarter end for large accelerated filers and accelerated filers 45 days after quarter end for non-accelerated filers
Current Report on Form 8-K	4 business days after event requiring report, unless otherwise specified in Form 8-K	4 business days after event requiring report, unless otherwise specified in Form 8-K

* Applies when company has at least a 12-month Exchange Act reporting history and has previously filed at last one Form 10-K.

Trap for the Unwary
“Rapid Disclosure or Slow Capital”: Short Form 8-K
Triggers Can Significantly Delay Financing

Form 8-K requires reporting many events within four business days, including the entry into, material amendment of or termination of a material contract, significant acquisitions or dispositions, public announcement of financial results for a completed fiscal period (i.e., earnings releases), incurrence of material financial obligations or entry into material off-balance sheet arrangements, authorization of exit or disposal plans that will result in material charges being incurred, amendments to the company’s charter documents that are not approved by stockholders, the hiring or departure of certain executive officers, and the appointment or resignation of directors. Like the failure to timely file a Form 10-Q or Form 10-K, failure to report certain of these items in time will result in a public company’s inability to use a short-form registration statement to raise additional capital in the public markets for 12 months. Instead, a late filer will have to use the same Form S-1 long-form registration statement used for the IPO.

A new public company should have adequate controls in place to ensure that events that trigger Form 8-K filing obligations are quickly identified and reported on a timely basis. At a minimum, this should include designating certain individuals to stay on the lookout for triggering events. The individuals should be in a position to spot the triggering events in advance, such as those involved with board activities and legal and finance.

CEO and CFO Certifications, Disclosure Practices and Internal Controls. Public company CEOs and CFOs will certify each annual report on Form 10-K and quarterly report on Form 10-Q. These certifications, which are referred to as the Sarbanes-Oxley Sections 302 and 906 certifications, are submitted as exhibits to each periodic report. The certifications cover two main areas: (1) the accuracy of the report, including the financial statements and related information, and (2) the existence and adequacy of, and the responsibility of the CEO and CFO with respect to, the company’s disclosure controls and procedures and internal control over financial reporting. To ensure that a disclosure system is in place to backstop these

certifications, each public company will maintain disclosure controls and procedures, or “DC&Ps,” and internal control over financial reporting.

Disclosure Controls and Procedures. DC&Ps are controls and procedures designed to ensure that the company records, processes, summarizes and discloses on a timely basis information required to be disclosed in Exchange Act filings. These are broad in scope and extend beyond financial matters to cover all controls and procedures relating to required disclosures. Most widely traded public companies have followed an SEC recommendation to establish a nonboard “Disclosure Practices Committee” of officers and employees with responsibility to oversee the DC&Ps that support the CEO and CFO certifications.

Internal Control Over Financial Reporting. Internal control over financial reporting includes policies and procedures that track transactions in assets, control receipts and expenditures, and protect assets. The most costly and controversial aspect of Sarbanes-Oxley is the internal control requirement of Section 404. Section 404 and related SEC rules require each public company to include in its Form 10-K a management report on the effectiveness of the company’s internal control over financial reporting. A newly public company is not required to comply with the Section 404 requirements until the second Form 10-K filed after completion of the IPO. At that time, unless the company is an emerging growth company (see discussion in Chapter 5) or a non-accelerated filer, Form 10-K must also include an audit-like attestation of management’s assessment of the effectiveness of internal controls.

The Annual Proxy Statement and Annual Report to Stockholders

A public company’s proxy statement for its annual meeting of stockholders, along with its annual report to stockholders, plays an increasingly important public disclosure role. These documents provide an annual, formal communication from management to the company’s stockholders. They also serve as an annual corporate governance check-up—not only for compliance with Sarbanes-Oxley, but also for other governance and disclosure mandates, including extensive disclosure regarding executive compensation.

The Proxy Statement

During the first several months of each year, a public company's senior management and professional advisors will expend significant energy preparing for the company's annual meeting of stockholders. Much of this time will be spent preparing the company's proxy statement. The proxy statement informs stockholders about the agenda for the stockholders' meeting and solicits a proxy from each stockholder to vote his or her shares at the meeting in the manner specified in the proxy card.

The SEC's Schedule 14A outlines the information that a company must include in its annual proxy statement. This includes information relating to the meeting and proposals to be acted upon, which normally includes the election of directors, but also goes beyond that information to include extensive corporate governance disclosure. The proxy statement will include detailed information regarding the board, including the independence of directors and the composition and function of the board committees.

Executive Compensation and CD&A. The proxy statement will include detailed information about executive and director compensation. Compensation-related disclosures will include both compensation data and some narrative discussion related to executive and director compensation. The requirements for companies that do not qualify as emerging growth companies are more extensive than those that apply to emerging growth companies; they include a Compensation Discussion and Analysis section aimed at providing a plain-English discussion of the objectives and implementation of executive compensation programs and the underlying reasons for the programs (basically, MD&A for executive compensation). As discussed further in Chapter 5, emerging growth companies may elect to comply with the less onerous executive compensation disclosure rules that apply to smaller reporting companies, which allows them to provide more limited compensation data for fewer executive officers and avoid including a Compensation Discussion and Analysis section.

Say-on-Pay and Other Rules Focusing on Excessive Executive Pay. The Dodd-Frank Act expanded executive compensation requirements to include a nonbinding stockholder vote on the compensation disclosed for executive officers, or "say-on-pay" vote, every one, two or three years, and a separate nonbinding vote on how frequently to hold the say-on-pay vote. Beginning

in 2018, SEC rules adopted under the Dodd-Frank Act will require disclosure of the ratio of a company's CEO's annual total compensation to that of the company's median employee. The Dodd-Frank Act also requires the SEC to enact rules on executive pay for performance disclosures and executive compensation clawback policy requirements, but as of March 1, 2016 these rules have not yet been finalized. So long as a company qualifies as an emerging growth company, it will be exempt from all of these requirements.

Shareholder Proposals. Under certain conditions described in Rule 14a-8 under the Exchange Act, a public company must include in its proxy materials "qualifying" proposals from a stockholder at no expense to that stockholder.

The Annual Report to Stockholders

The SEC requires an annual report to stockholders to accompany or precede a company's proxy statement for any stockholders' meeting at which stockholders will elect directors. Unlike the corporate governance focus of the annual proxy statement, the annual report conveys information regarding the company's business, management and operational and financial status. The annual report has content requirements similar to Form 10-K but serves a different purpose. Form 10-K fulfills the year-end reporting requirement to the SEC and is not necessarily designed to communicate with stockholders. The annual report is intended principally as a communication device—the most direct message from the company to its stockholders—and is generally issued in an attractive format to facilitate this purpose.

PRACTICAL TIPS

"Wrap It Up at Low Cost": Fulfilling the Annual Report Requirement With the "10-K Wrap"

Rules 14a-3 and 14c-3 under the Exchange Act specify the minimum content requirements for the annual report to stockholders, which include financial information and MD&A, stock and dividend information, operation and industry segment information and director and officer information. Because the content requirements of the Form 10-K satisfy most of the minimum annual report content requirements, an increasingly common and practical format is the Form 10-K

PRACTICAL TIPS

“Wrap It Up at Low Cost”: Fulfilling the Annual Report Requirement With the “10-K Wrap” (cont’d)

“wrap” annual report: several pages of company messages and materials (e.g., president’s or chairman’s letter and photographs of company management or products) that simply wrap around the Form 10-K. This avoids duplication between the annual report to stockholders and the 10-K, reduces costs and gets a valuable SEC-filed report into stockholders’ hands. Companies may send only their Form 10-K along with the proxy statement to comply with the annual report requirement (so long as it includes all material that is required under the applicable rules), although the “wrap” is generally considered more shareholder-friendly.

Voluntary Public Disclosure Under Regulation FD

The periodic reports and other filings described above relate to public company disclosures that are mandatory—they are required by SEC, NYSE or Nasdaq rules. Virtually all other communications by a public company, both formal and informal, are voluntary. These communications include earnings releases and calls, analyst conferences, one-on-one discussions with analysts and press interviews. Though voluntary, these communications are critically important as senior executives strive to maintain a dialogue with professional analysts, the financial press and major stockholders to help market professionals follow the company’s stock and to provide stockholders with access to management. Yet private discussions with analysts and major investors can create an imbalance of information—and, prior to Regulation FD, institutional stockholders and professional analysts often had more information than other investors. The SEC issued Regulation FD to correct this situation.

Regulation FD (short for Fair Disclosure) prohibits a company from selectively disclosing material nonpublic information to securities market professionals or to security holders when it is reasonably foreseeable that the holders will trade on the basis of that information. Instead, a company has an obligation to disseminate that information in a broad, nonexclusionary manner, such as by a press release, an SEC filing or a publicly accessible

conference call or webcast of which the public has reasonable advance notice. The timing of the company’s public disclosure depends on whether the selective disclosure was intentional or unintentional. If intentional, the company must make public disclosure of material information simultaneously with any selective disclosure (in practice, this generally means prior to the nonpublic disclosure). If unintentional, the company must make public disclosure promptly after the inadvertent disclosure of material information—meaning within 24 hours after the inadvertent disclosure or by the next opening of the NYSE.

PRACTICAL TIPS

“Good Policy Makes for Good Disclosure”: Adopting a Disclosure Policy

To help the company comply with Regulation FD and other public disclosure regulations, including Regulation G (see Chapter 6), adopt a corporate disclosure policy. Some key elements of a disclosure policy include:

Designate Spokespersons. Designate only specific persons (e.g., the chairman, chief executive officer, chief financial officer and chief investor relations officer) as spokespersons.

Limit Timing of One-on-One Calls and Meetings. Whenever practicable, limit the timing of conversations with analysts and/or investors to the period following an earnings conference call up to the blackout period.

Limit Subject Matter of One-on-One Meetings. The spokespersons should limit their responses in these conversations to elaboration of previously disclosed or generally known information. Ensure that the analyst or investor understands that the company does not intend to disclose material information selectively.

Do Not Comment on Analysts’ Projections or Previous Earnings Guidance. The company generally should not comment on or confirm previous earnings guidance or individual analyst projections, nor should it refer to or distribute individual analyst projections.

PRACTICAL TIPS***“Good Policy Makes for Good Disclosure”:* Adopting a Disclosure Policy (cont’d)**

Do Not Comment on Transactions and Unusual Market Activity. Unless required by law, the company should not respond to inquiries regarding potential financings, restructurings, acquisitions, mergers or other transactions or unusual market activity.

Be Cautious in Interviews With News Media. Treat the media as if communications were subject to Regulation FD.

Insider Reporting and Trading Restrictions

The directors, executive officers and significant stockholders of a public company are subject to a number of limitations and reporting obligations in their ownership and trading of the company’s securities. Compliance with these rules requires strong procedures for both the company and the insider.

Section 16 Reporting Obligations of Directors, Executives Officers and 10% Beneficial Stockholders

Section 16(a) of the Exchange Act requires directors and executive officers of a public company, as well as persons who beneficially own more than 10% of the company’s outstanding stock, to publicly report their beneficial ownership of the company’s stock to the SEC. Each insider first files a Form 3 as the initial report with the SEC listing all of the insider’s holdings of the company’s securities, including equity awards. Generally, the Form 3 is due within ten days of the event triggering compliance—for example, within ten days after a person becomes an officer, director or greater than 10% stockholder of a public company. Insiders of newly public companies file a Form 3 on the date the company becomes a reporting company under the Exchange Act.

Generally, any change that occurs in an insider’s beneficial ownership of the company’s securities is reported on Form 4. Insiders must file a Form 4 within two business days after a change in beneficial ownership. The two-day reporting period begins when a transaction is executed, not when it settles. Insiders may also be required to file a Form 5 within 45 days after the

end of the company’s fiscal year. Form 5 is required unless the insider either had no reportable transactions during the year or had already filed one or more Form 4s during the year covering all transactions required to be reported on Form 4 or 5.

Failure to timely file a Form 3, 4 or 5 can result in substantial penalties to the insider. In addition, a public company must disclose in its proxy statement any insiders who reported transactions late or failed to file required reports during the fiscal year.

Section 16(b)—Short-Swing Profit Liability

Another aspect of Section 16 is the short-swing profit liability provisions of Section 16(b) of the Exchange Act. This provision makes an insider of a public company liable to the company for “short-swing trades”—that is, for any profits the insider receives from the purchase and sale (or sale and purchase) of securities of the company within a period of less than six months. The insider is liable for profits realized in both cash and noncash form, such as securities. The test for Section 16(b) liability is purely objective. It does not matter whether the insider was aware of confidential information, whether confidential information was material, whether the insider relied on the information in making a transaction or whether the insider acted in good or bad faith.

Schedules 13D and 13G Reporting Requirements for 5% Stockholders

Entirely apart from any Section 16(a) reporting obligations they may have, stockholders who beneficially own more than 5% of a public company’s stock must report their stock ownership to the SEC on Schedule 13D or, in certain cases, Schedule 13G. Within 45 days following the end of the calendar year in which a company completes its IPO, every person (including directors and officers) that beneficially owned more than 5% of the company’s stock at the time of the IPO must report that ownership to the SEC on a short-form 13G. These initial 5% stockholders are referred to as “exempt stockholders” because their shares were acquired prior to the company’s IPO.

After a company is public, any exempt stockholder who acquires more than 2% of the company’s stock in a 12-month period, or any other stockholder

who acquires 5% or more of the company's stock (following its IPO), may be required to file a Schedule 13D, which is longer than Schedule 13G.

Rule 144 Restrictions on Trading Restricted and Control Securities

The Securities Act requires that a sale of a security be registered with the SEC unless the security or transaction qualifies for an exemption. Among other things, this general requirement applies to sales of stock by officers, directors and affiliates of a newly public company. Rule 144 provides the most frequently used exemption for the resale in market transactions of restricted and control securities. "Restricted securities" are generally securities that have been issued in transactions that were not registered with the SEC and include all of the common stock held prior to the IPO and not specifically registered for resale at the time of the IPO. "Control securities" are any securities owned by any person who is an "affiliate" of the issuer. An "affiliate" is a person that controls, is controlled by or is under common control with the issuer, including directors, executive officers and major stockholders of the issuer.

The following table summarizes the conditions applicable to the resale under Rule 144 of restricted stock of a company that has been public for at least 90 days held by affiliates as compared to those held by nonaffiliates.

Affiliate or Person Selling on Behalf of an Affiliate	Nonaffiliate (and Has Not Been an Affiliate During the Prior Three Months)
<p>During the six-month period after restricted shares were acquired—no resales under Rule 144 permitted.</p> <p>After six-month holding period—public resales permitted in accordance with all Rule 144 requirements including:</p> <p>Current public information,</p> <p>Volume limitations,</p> <p>Manner of sale requirements for equity securities, and</p> <p>Filing of Form 144.</p>	<p>During the six-month period after shares were acquired—no resales under Rule 144 permitted.</p> <p>After six-month holding period but before one year—unlimited public resales under Rule 144 permitted except that the current public information requirement still applies.</p> <p>After one-year holding period—unlimited public resales under Rule 144 permitted; there is no need to comply with any other Rule 144 requirements.</p>

Conflict Minerals Disclosure

The SEC's Conflict Minerals Disclosure Rule generally applies to any reporting company that manufactures or contracts to manufacture a product that contains even a trace amount of conflict minerals (tin, tungsten, tantalum and gold) that are necessary to the functionality or production of the product. A company meeting that requirement must file a report on Form SD by May 31 of each year.

Form SD disclosure requirements vary depending on the circumstances for the particular company and product. The basic requirement is that a company perform a "reasonable country of origin" inquiry to determine whether any of the minerals originated in the Democratic Republic of the Congo or an adjoining country. Additional due diligence processes and the filing of a Conflict Minerals Report may apply if the company has reason to believe that any of its necessary conflict minerals may have originated in the Democratic Republic of the Congo or an adjoining country.

The reasonable country of origin inquiry and due diligence processes relating to supply chain source and chain of custody can be time- and labor-intensive. A company that will be subject to the Conflict Minerals Disclosure Rule should begin the inquiry and implement a compliance program well in advance of preparing its first Form SD report. The SEC has indicated in its Conflict Minerals Disclosure Rule "frequently asked questions" that a company that has recently completed an IPO is not required to file a Form SD or Conflict Minerals Report until the first calendar reporting year that begins no sooner than eight months after the effective date of its IPO registration statement.

Chapter 12



IPO as an Exit: Special Considerations for Private Equity and Venture Capital Investors

Time to Exit? Part I—Is an IPO Right for You? An Overview

One way to approach the IPO exit decision is to first determine whether to gain liquidity through an IPO exit strategy or through a sale of the company. If through an IPO, then determine a post-IPO liquidity strategy—secondary sales to the public, distribution to fund investors; or private sales or a sale of the company following the IPO. Analysis of the post-IPO liquidity strategy, and related issues, may affect the threshold exit decision. While this chapter does not address in detail the threshold IPO versus sale decision, it provides guidance on analyzing a variety of liquidity options.

Private equity and venture capital funds have multiple factors to consider when analyzing an exit strategy. Chapter 1 discusses many of these factors related to an IPO as an exit. In addition, a fund will need to consider, among other things, the strategy for liquidating its position; the time it will take to fully liquidate; the aggregate price it will receive for its investment when selling over time at prevailing market prices and how that price compares to a private sale; the fund's ability (or inability) to maintain certain economic and control rights with respect to the company; ongoing disclosure, including disclosure of affiliated relationships and transactions; and the heightened scrutiny of compliance with fiduciary duties by fund representatives on the board. Ultimately, it may be more difficult to exit a significant investment through the public offering process than a private sale, and the fund will have less control and more disclosure requirements. However, often the public will pay a higher price than a private buyer for a company with strong growth potential.

Time to Exit? Part II—IPO as Stalking Horse, or the Only Way Out

While many funds may want to exit an investment through a straightforward sale process to gain immediate liquidity, funds face situations where an exit is ripe, but a typical sales process may not yield significant or timely demand for the company. One strategy to stimulate demand is to begin or even complete an IPO while still seeking a private sale in a “dual track” approach. A strategic buyer may become more interested in a company if, in a competitive situation, it believes the company will gain resources or momentum through the public offering process. Regardless of whether the company is a competitor, a buyout will become more expensive and difficult after the target is public.

Going public also can be seen as an alternative to a sale, so it can effectively serve as another bidder in an exit process. If a sale is not completed and the company goes public, the company may increase its visibility and essentially market itself through public disclosure of its business, strategies and financial results. In some cases, a “two-step” sale—partial liquidity through an IPO at a short-term market peak, followed by a negotiated sale of control—could extract total higher value for a fund than a straight sale or complete liquidity through secondary sales to the public.

An IPO is expensive and consumes significant management time, so an IPO should not be used lightly to facilitate a complete exit through a private sale process. However, if an exit is appropriate and an IPO is otherwise a reasonable strategy, a “dual track” approach may be worthwhile to consider.

The Statistics

“Choosing the Exit Door”: Comparison of Venture-Backed IPOs to Private Sales

Traditionally, IPOs have been viewed as a preferred exit strategy for venture capital (“VC”) funds. Among other reasons, public offerings frequently result in the highest valuation and showcase successful investments. The table below summarizes the number of IPOs of VC-backed companies from 2008 to 2015.

The Statistics
**“Choosing the Exit Door”: Comparison of Venture-Backed
 IPOs to Private Sales (cont’d)**

However, exit by private sale (in both number and dollars) has always significantly outpaced exit by IPO.

Year	VC-Backed M&A Exits	VC-Backed IPOs*
2015	525	77
2014	350	117
2013	525	81
2012	492	48
2011	477	50
2010	386	67
2009	472	13
2008	360	7

Source: Thompson Reuters and National Venture Capital Association

* Includes all companies with at least one U.S. VC investor that trades on a U.S. exchange regardless of domicile.

Time to Exit? Part III—Getting Liquidity Post-IPO

Often the most important issue a fund will need to analyze in a going-public exit strategy is how to actually liquidate its position in the portfolio company. A number of factors come into play, including market demand, the terms of any registration rights agreement, lockup agreements, insider trading policies and securities laws restrictions, including those prohibiting sales while in possession of material, nonpublic information. The following are three post-IPO paths to liquidity.

Sale of Shares to the Public (Secondaries)

The sale of shares by the fund to the public in a portfolio company’s initial public offering or through subsequent registered offerings is a fundamental

liquidity strategy. When analyzing this strategy, a fund should consider how the following factors would affect its ability to achieve liquidity:

- An IPO is primarily a capital-raising event—current investors may be limited in the amount they can sell in the IPO.
- Market demand for secondary offerings will affect the amount and timing of sales by the fund. If the public market float and trading volume are small, the fund may not be able to sell sizable blocks of its shares to the public.
- While the public market may value the shares at a higher multiple, the market price may deteriorate over time, and sales by officers, directors and other significant stockholders could further depress the trading price.
- Registration rights agreements almost always contain restrictions on forcing the company to register shares, including provisions allowing the underwriters and company to cut back the amount of shares sold by an investor in an offering.
- Significant investors are typically locked up, or restricted from selling shares, for 180 days following an IPO and may be locked up for various periods after later public offerings.

Funds can take a number of steps to assess whether an IPO of a portfolio company will achieve satisfactory liquidity for its equity in the company through secondary offerings. First, a fund should evaluate the company’s business prospects and ability to deliver operating results after the IPO that will maintain or increase public stockholder value. This would include consideration of how the company will report results under SEC guidelines and which results public investors and analysts would find important.

Second, a fund should analyze its rights under the portfolio company’s organizational agreements and any registration rights and other agreements relating to the fund’s rights to participate in public offerings.

Third, the fund should talk with investment banks specializing in the company’s particular industry about the probable strength and depth of the market for secondary offerings after the IPO.

The market for secondary offerings will depend, in part, on the size of the company and offering, the level of public interest in the company, the strength of the company's industry or sector, the company's growth plan and strategies, and the outlook for the stock market generally. All of these matters can affect whether the fund may be able to liquidate its position quickly through a small number of large offerings or more slowly through a large number of small offerings. Some statistics suggest that in the last 16 years, secondary offerings at IPO ranged from zero to 21% of offerings with 11 below (or well below 10%), three between 10% and 12% and two above 12%.

Distribution of Shares to Investors

As an alternative to a fund handling the liquidation of portfolio company shares, a fund should analyze the possibility of distributing the shares of the company to its investors following the IPO. This approach has several advantages. For instance, distributions shortly after the IPO may "lock in" the return on investment that is otherwise subject to the volatility of the company's trading price. This would provide a fund certainty as to its carried interest and its track record for investment performance. In addition, assuming the fund can distribute the shares tax-free, distribution allows each investor to choose whether to sell or hold the shares based on the investor's own view of the company's long-term prospects and its preferences regarding the timing of taxable gains. Moreover, the investors in a fund may not be subject to the same restrictions on transfer applicable to the fund if the fund is an affiliate or has a representative on the board of directors. A fund may also prefer to distribute the shares if the time needed to dispose of the shares (without adverse price consequences) will exceed the fund's life and expected wind-down period.

On the other hand, a fund's distribution of shares to its investors would cause it to lose control of the timing and method of liquidating the investment. If the fund anticipates that the trading price will increase over time, or if it expects an acquisition of the public company at a premium, fund's investment return would be lowered by prematurely distributing the shares. In addition, certain investors may not want to hold the shares directly or make subsequent disposition decisions themselves.

As an initial step in determining whether liquidating or distributing the portfolio company shares is a viable strategy, a fund should review its

investment agreements. In particular, the fund should examine the terms and conditions of any requirements in the investment agreements concerning distributing public portfolio company shares and distribution allocations, including valuations for carried interest purposes.

Sales of Shares Outside of Public Offerings or Sale of the Whole Company

After a company is public, a fund will likely have the ability pursuant to a registration rights agreement to require a portfolio company to register the fund's shares to facilitate a sale to the public. However, a privately negotiated sale by a fund can have advantages over a direct sale to the public through a registered offering. Registered public offerings consume a lot of time and can distract management's attention from the important task of running the company. The filing of a registration statement may also signal to the public that significant sales are about to occur, which can depress the market price for the company's stock.

As a result, a fund seeking liquidity might evaluate selling shares of a public company in a privately negotiated transaction. A portfolio company having shares registered with the SEC does not preclude a private sale if the transaction meets certain exemptions under the securities laws. A privately negotiated sale would typically take the form of a large block sale transaction to one or more sizable institutions. The sale either would be pursuant to a registration exemption, where the buyer might receive the shares subject to transfer restrictions, or would be registered with the SEC for a direct sale to the institution.

A fund may also sell unregistered, or restricted, stock to the public pursuant to Rule 144, with certain limitations that vary depending on whether the fund is an "affiliate" or "nonaffiliate" of the company. We describe Rule 144 limitations in greater detail in Chapter 11 under "Rule 144 Restrictions on Trading Restricted and Control Securities." A fund will likely be deemed an affiliate if it owns more than 10% of the company.

Of course, a publicly traded company may also be sold in its entirety to a private acquirer or another public company. Even if the fund had drag-along rights before the IPO, enabling the fund to cause other stockholders to vote in favor of a sale, the drag-along rights customarily would have terminated at the time of the IPO. As a result, a sale of the publicly traded company

would require a proxy solicitation of all of the voting stockholders, including the fund. Because lawsuits challenging a public company sale are, unfortunately, all too common, a sale typically involves extensive board meetings and process and almost always includes a fairness opinion. A substantial portion of the lawsuits have, historically, resulted in a relatively quick settlement.

What Happens to My Economic and Control Rights?

Venture and private equity investors often hold preferred stock with dividend preferences, liquidation preferences, anti-dilution protections and other economic rights. In addition, such investors often obtain certain kinds of control regarding significant company actions and the board through contracts and charter provisions negotiated with the company at the time of their investment. In the event of an IPO meeting certain specifications, however, the investors' preferred stock will convert to common stock, resulting in the loss of the economic preferences, and many of the controls and contractual rights—such as preemptive rights to acquire stock in future financings, rights of first offer and co-sale, or tag-along, rights, drag-along rights, and protective provision “blocking rights” with respect to key corporate actions—will terminate. One exception is registration rights, which typically continue in force for several years after the IPO.

Most often, the company's IPO also terminates or substantially reduces the fund's rights to board seats, and the company becomes subject to director independence requirements. Both NYSE and Nasdaq require a majority of the board, as well as certain committees of the board, to be independent. Under certain circumstances, a representative from a fund can be considered independent under stock exchange rules; however, Sarbanes-Oxley has stricter Audit Committee standards for an “affiliate” of the company. Chapter 4 provides further detail on director independence requirements. In addition to independence requirements and the loss of contractual rights to a board seat, institutional stockholders may apply pressure to limit control of the board by pre-public investors.

Even if the fund's contractual right to a board seat terminates in the IPO, the company and fund may consider nominating one or more directors for election or reelection to the board. Nothing precludes the fund advocating for the company to nominate a representative to the board, and company stockholders typically vote in favor of the director slate proposed by the company.

Dealing With the Underwriters

An IPO requires the involvement of a number of parties, and the level of a fund's participation may vary depending on whether it is selling in the IPO and the extent of its equity stake in the company. Generally, a fund with a significant stake in the portfolio company will want to have input on the investment bank's selling strategies and the “story” told in the prospectus used to sell the offering. Accordingly, representatives of a lead investor often participate in the drafting of the offering prospectus. In addition, certain information about the fund's holdings and involvement with the company will be disclosed in the prospectus.

If the fund is not selling shares in the IPO, its direct involvement may be limited to being a party to a lockup agreement restricting the sale of any of its shares for 180 days after the IPO and to filling out a questionnaire confirming matters that are required to be disclosed in the prospectus. A lead fund will want to proactively review drafts of the prospectus before filing and participate in the process.

If the fund sells shares in the IPO, the underwriters will also expect the fund to become a party to the underwriting agreement and to provide representations and indemnification related to the fund's shares. In some IPOs, the underwriters request indemnification for securities law violations (mainly material misstatements and omissions in the prospectus) from major stockholders, but typically financial sponsors do not provide indemnification for broad securities law violations.

In some cases, the underwriters may ask the fund to execute powers of attorney and other documents prior to the marketing of the offering that commit the fund to transfer the shares it agrees to sell in the offering, if the offering is successful. This assures the underwriters that the fund will not change its mind or interfere with the pricing of the offering after the underwriters are publicly marketing the offering. If the fund effectively controls the final decision as to the price and terms of the sale, the underwriters may not require these documents. A fund should look to its own counsel, and not rely on company counsel, to review any requirements relating to its sale of stock and entrance into the underwriting agreement in connection with the IPO.

Board Duties and Formalizing Relationships

Following an IPO, board members' fiduciary duties become subject to greater scrutiny. While a board member always needs to consider the interests of all stockholders, regardless of whether the company is private or public, a director's risk and level of exposure for liability for failing to do so increase once a company is public. The reasons for this are several, including that public reporting and compliance make the workings of the company and its board more transparent once it is public and that the effect of board decisions on company value is more readily determined through movements in the public company's stock price. Chapter 4 discusses board member considerations.

Public companies are required to report transactions with related parties and possibly obtain approval of these transactions by disinterested directors. Accordingly, prior to an IPO, the company and any affiliated fund should consider any arrangements between the company and the fund or directors representing the fund, including those related to management fees. Those arrangements should be formalized and disclosed in the IPO prospectus to avoid approval issues and post-IPO claims that they are inappropriate.

SEC Filing Requirements

Any stockholder beneficially owning more than 5% of a public company's stock must report its stock ownership to the SEC on Schedule 13D or 13G. Funds generally report ownership on Schedule 13G, which must be filed within 45 days following the end of the calendar year in which the company completes its IPO. Schedule 13G must be amended annually for any changes in beneficial ownership. The longer form Schedule 13D may be required in certain cases.

In addition to the rules requiring a Schedule 13D or 13G, executive officers, directors and 10% stockholders (considered "insiders") are subject to Section 16 of the Exchange Act and must file statements of their beneficial ownership on Forms 3, 4 and 5. Section 16 also prohibits insiders from taking short-swing profits by buying and selling securities within a six-month period. Chapter 11 provides an overview of Schedules 13D and 13G and Section 16 reports.

"Talk the Talk"—Glossary of Common IPO Terms



The initial public offering has a distinct lexicon. Here is a list of common IPO terms that can help you navigate discussions about the IPO process.

10b-5. Reference to Rule 10b-5 of the Exchange Act, which establishes liability for fraudulent activities in a securities offering and for material misstatements or omissions in the offering materials, such as the offering prospectus.

Aftermarket. Trading in the IPO subsequent to its offering is called the "aftermarket." Trading volume in IPOs is extremely high on the first day due to aftermarket purchases. Trading volume can decline subsequently in the following days.

Aftermarket performance. The price appreciation (or depreciation) in IPOs is measured from the offering price going forward. However, to obtain a better benchmark of IPO aftermarket performance, some investors track performance from the first day close.

Allotment. This is the process whereby those who apply are given shares.

Blue line, digital blue (or similar terms). References to the financial printer's providing a final, typeset version of the preliminary or final prospectus for final approval before printing the prospectus in quantity.

Book runner. The managing or lead underwriter.

Building a book. The underwriters' process of building interest in the initial public offering and obtaining indications of interest, and specific price and quantity information, from potential investors.

Cheap stock. Securities, commonly stock options or other equity awards, granted with an exercise price less than fair market value.

Comfort letter (or cold comfort letter). The letter from the company's auditors to the underwriters regarding the financial data and financial statements in the registration statement, which is delivered at pricing.

Comment letter. A letter from the SEC commenting in detail on the registration statement filed with the SEC, after its review of the initial registration statement or amendments to the filing.

Confidential submission. Under the JOBS Act, EGCs can file a Form S-1 on a confidential basis, and to make the contents public only 15 days prior to the road show for the IPO.

D&O questionnaire. A questionnaire that the company's directors, officers and major stockholders will be required to complete concerning matters that may be required to be disclosed in the registration statement.

Directed share (or friends and family) program. A program in which certain persons close to the company (so-called "friends and family") can purchase a certain amount of shares in the offering.

Drafting sessions. Meetings with the IPO working group, in person or by conference call, to discuss in detail the drafting of the prospectus.

Due diligence defense. The defense the underwriters have to liability for material misstatements or omissions in the offering documents, which is established by the conduct of reasonable due diligence as prescribed in the securities laws.

EGC. Emerging growth company, as defined in the JOBS Act and Section 2(a)(19) of the Securities Act. An EGC is a company with annual gross revenues of less than \$1 billion during its most recent fiscal year. A company retains emerging growth company status until the earliest of (a) the end of the fiscal year in which its annual revenues exceed \$1 billion; (b) the end of the fiscal year in which the fifth anniversary of its IPO occurred; (c) the date on which the company has, during the previous three-year period, issued more than \$1 billion in nonconvertible debt; or (d) the date on which the company qualifies as a large accelerated filer.

Electronic road show. A road show presentation given over the Internet or other electronic means, where the participants listen to the oral presentation and remotely view the slide presentation.

Exchange Act (or '34 Act). The Securities Exchange Act of 1934, as amended, and associated rules and regulations of the SEC.

FAST Act. The Fixing America's Surface Transportation Act, which amended aspects of the JOBS Act by including a number of provisions designed to further facilitate capital raising by EGCs and secondary trading in privately placed securities and to modernize certain public company disclosure requirements.

FINRA. The Financial Industry Regulatory Authority, which is the self-regulatory organization governing the conduct of the underwriters and broker-dealers in the IPO.

Flipping. When an investor buys an IPO at the offering price and then sells the stock soon after it starts trading on the open market. The underwriters try to discourage flipping by initially placing stock in the hands of long-term investors, particularly ones that have promised aftermarket orders.

Float. When a company is publicly traded, a distinction is made between the total number of shares outstanding and the number of shares in circulation, referred to as the float. The float consists of the company's shares held by the general public. For example, if a company offers 2 million shares to the public in an IPO and has 20 million shares outstanding, its float is 2 million shares.

Free-writing prospectus. Any written or graphic communication, other than a prospectus that meets the statutory requirements of the Securities Act, that constitutes an offer to sell, or a solicitation of an offer to buy, securities that are or will be the subject of a registration statement.

Gun-jumping. Any publicity or other activity that might be considered an illegal offer to sell the company's securities prior to the filing of the registration statement.

JOB Act. The Jumpstart Our Business Startups Act of 2012, which provided several significant changes related to the IPO process for a company that qualifies as an emerging growth company (*see* EGC).

Lockups. An agreement by the company, directors, officers and certain stockholders to not sell any company securities for a prescribed period of time after the IPO, typically 180 days.

Over-allotment option (or Green Shoe, “shoe”). An option that gives the underwriters the option to purchase up to 15% additional shares, on the same terms that they purchased the original shares, for a period up to 30 days after the initial public offering.

Pre-filing period. The period after the company becomes “in registration” and before the company has filed its registration statement. There is no bright line as to when a company first becomes “in registration,” but, at the latest, a company is in registration once it reaches an understanding with a managing underwriter to lead its public offering. During the so-called “pre-filing period” of the IPO, the company and underwriters may not solicit offers to buy the company’s securities to be offered in the IPO.

Price range. The range of prices per share stated in the preliminary prospectus as the range in which the company expects it will ultimately price its stock for sale to the public.

Pricing. The determination by the company of the per-share price at which the company will offer its stock to the public, after consultation with the underwriters following the road show and effectiveness of the registration statement.

Pricing committee. A board committee, usually composed of the CEO, CFO and one or two independent directors, that will determine at pricing the final offering price and approve the underwriting agreement.

Prospectus. The “glossy” portion of the registration statement given to prospective investors.

Red herring or “reds.” The preliminary prospectus, printed with a red legend on the side of the cover stating that the prospectus is subject to completion.

Response letter. A letter from the company or counsel for the company, responding to the SEC’s comments on the registration statement.

Road show. Representatives from the company meet with prospective investors (generally institutional investors such as mutual funds, pension funds and the like) in various cities and make presentations about the company.

Road show presentation. The slide show presentation (and related remarks) prepared for investor presentations on the road show.

S-1. Form S-1 is the registration statement filed with the SEC to register securities for an offering. It includes the prospectus.

S-K. Regulation S-K includes and describes items of disclosure required to be included in the nonfinancial portion of the registration statement on Form S-1.

S-X. Regulation S-X includes and describes items of disclosure required to be included in the financial portion of the registration statement on Form S 1.

Sarbanes-Oxley (or Sox). The Sarbanes-Oxley Act of 2002, which was the source of a great number of securities reforms increasing the legal compliance requirements of public companies.

SEC. The U.S. Securities and Exchange Commission.

Securities Act (or ‘33 Act). The Securities Act of 1933, as amended, and associated rules and regulations of the SEC.

Summary (or Box). The summary of the company and offering contained in the front of the prospectus, usually surrounded by a box border.

Test-the-waters communications. In a registered offering, Section 5(d) of the Securities Act permits EGCs and persons authorized to act on their behalf to engage in oral or written communications with qualified institutional buyers and institutional accredited investors to determine whether those investors might be interested in a contemplated securities offering, either before or after the date a related registration statement is filed with the SEC. Section 5(d) excludes these communications from the definition of

“offer” under Section 5 (other than the requirement to deliver a final prospectus to investors under Section 5(b)(2)). As a result, these communications will not result in a gun-jumping violation as long as they are made in strict compliance with Section 5(d).

Window. The theoretical period in which the company may optimally sell, or may only be able to sell, its stock in the IPO.

Appendix 2: Sample IPO Time and Responsibility Schedule

SCHEDULE OVERVIEW

Date	Event
Day One	Preliminary organizational meeting
Week One	First draft of registration statement distributed by company counsel
Week Two	First drafting session
Week Three	Revise and distribute registration statement
Week Four	Second drafting session
Week Five	Third drafting session
Week Six	Final drafting session, at printer
Week Seven	File/submit registration statement with SEC
Week Eleven	Receive comments from SEC
Weeks Eleven—Seventeen	Clear SEC comments; file necessary amendments
	File registration statement with SEC (at least 15 days prior to start of road show, if confidential submission process used)
	Begin road show
Week Eighteen	Complete road show
Week Nineteen	Company and underwriters agree on price
	Closing/stock begins trading

ABBREVIATION KEY

Participants	Abbreviation
Company	CO
Company Counsel	CC
Managing Underwriter(s)	UW
Underwriters' Counsel	UC
Auditors	A
Transfer Agent and Registrar	TA

IPO TIME AND RESPONSIBILITY SCHEDULE

Date	Activity	Participants
Preliminary Organizational Meeting	Prepare and distribute “publicity” memorandum for distribution to officers and directors of company regarding informational restrictions in connection with offering	CC
	Begin drafting registration statement	CO, CC
	Determine whether Company will meet definition of “emerging growth company,” which would permit company to take advantage of IPO on-ramp provisions, including confidential submission of registration statement.	CO, CC
	Emerging growth company status applies to a private company with less than \$1 billion in total annual gross revenue during its most recently completed fiscal year.	
	Meetings between company and company counsel concerning “corporate cleanup.” The following matters should be discussed:	CO, CC
	(a) Amendments to Articles of Incorporation and Bylaws	
	(b) Adjustment of individual stockholders’ holdings in company, if desired	
	(c) Creation of, or revisions to, employment agreements	
	(d) Creation of stock option, stock purchase and other desired employee benefit plans	
	(e) Revision of existing employee benefit plans to comply with securities law requirements	
	(f) Verification that all existing employee benefit plans comply with requirements of ERISA and other applicable laws	
	(g) Determination of status after offering of stockholders’ and voting trust agreements and other restrictions on voting and transfer of stock	
	(h) Examination of covenants in loan agreements, leases and other contracts that restrict, or limit use of proceeds of, a public offering, or that restrict dividend payments	
	(i) Discussion of stockholder rights plans	

Date	Activity	Participants
	(j) Collection of exhibits to registration statement and conversion to electronic form	
	Preliminary negotiation of terms of offering	CO, UW
	Meeting between company and auditors concerning need for change in accounting procedures (e.g., instituting necessary procedures and controls to produce reports required under the Exchange Act) when company is a public company	
	Negotiate letter of intent or term sheet, if applicable	CO, CC, UW, UC
Week One	Organizational meeting, at which the following matters should be discussed:	CO, CC, UW, UC, A
	(a) Terms of offering	
	(1) primary and secondary shares	
	(2) over-allotment option (“Green Shoe”)	
	(b) Timetable	
	(c) Emerging growth company status for IPO on-ramp provision and, if company qualifies, whether to take advantage of confidential submission process and other benefits available to EGCs (including ability to provide only 2 years (vs. 3) of audited financial statements	
	(d) Assignment of responsibilities for tasks	
	(e) Selection of financial printer	
	(f) Selection of banknote company	
	(g) Selection of transfer agent	
	(h) Selection of stockholder relations advisor	
	(i) Appropriateness of certain “corporate cleanup” matters (e.g., employment agreements, shareholder rights plans) in light of marketing considerations	
	(j) Listing on the stock exchange	
	(k) Discussion of required financial statements and of any special accounting problems	
	(l) Discussion of any anticipated disclosure problems	

Date	Activity	Participants
	(m) Discussion of anticipated FINRA or blue sky problems	
	(n) Arrangements with stockholders who have registration rights	
	(o) Desirability of pre-filing conference with the SEC, blue sky authorities and/or FINRA	
	(p) Recapitalization of company (e.g., stock split or reverse stock split) that will be required prior to offering	
	(q) Discussion of any desired stockholder concessions, such as lockup agreements	
	(r) Discussion of press release under Rule 135 of the Securities Act	
Week Two	Distribute first draft of registration statement	CO, CC
	Distribute list of participants (including direct lines and home phone numbers)	CC
	Draft and distribute a time and responsibility schedule, including specific assignments of responsibilities	UW, UC
	Review each item of Form S-1 and appropriate items of Regulation S-K and Regulation C	CC
	Examine company's charter, bylaws, minute books, loan agreements, stockholder agreements, etc., to determine, among other things, the following:	CC
	(a) Due incorporation	
	(b) Good standing (consider sending for long form certificate from Secretary of State with certified copies of all charter documents and requesting a tax paragraph or separate tax certificate)	
	(c) Due qualification to do business in the jurisdictions required (consider obtaining certificate from company's secretary showing each jurisdiction in which company has property or operations)	

Date	Activity	Participants
	(d) Existence of preemptive rights and whether they have been honored, cumulative voting provisions, restrictions on issuance or transfer of stock, declaration and payment of dividends or issuance of debt and prior compliance therewith, and any other material limitations on company's operations	
	(e) Compliance with corporate requirements of company's state of incorporation relating to company's outstanding securities	
	(1) Corporate authority to issue stock and proper corporate action	
	(2) Minimum capitalization	
	(3) "Fully paid and nonassessable" (consider obtaining certificate of company's treasurer or auditors regarding full payment)	
	(4) Adequate consideration	
	(5) Form of stock certificate	
	Transmit due diligence document request list to company	UC
	Commence drafting necessary "corporate cleanup" documents (e.g., charter and bylaw amendments, employment agreements, stock option plans), documents necessary to effect any recapitalization and board resolutions necessary to authorize the public offering	CC, reviewed by UC
	Distribute first draft of registration statement	CO, CC
	Continue business due diligence and commence legal due diligence review of material contracts, litigation, claims and contingent liabilities, past corporate action (minute books, stock records, charter, bylaws, etc.), financial statements, documentation with regard to outstanding securities, etc.	UW, UC
	Send bid letters to appropriate financial printers	CC
	Send officers', directors' and 5% stockholders' questionnaires to officers, directors and 5% or more shareholders of Company	CO or CC

Date	Activity	Participants
	Begin preparation of initial report of beneficial ownership of equity securities (Form 3) required under Section 16(a) of the Exchange Act for officers, directors and 10% or more stockholders of company (required to be filed by the effective date of Exchange Act registration)	CO, CC
	Commence preparation of underwriting agreement, agreement among underwriters, underwriters' questionnaire, underwriters' power of attorney ¹ and preliminary blue sky survey	UC
	If secondary offering is involved, prepare selling shareholders' questionnaire and other selling shareholder documents, including a custody agreement and a power of attorney, if necessary	CC (or Selling Shareholders' Counsel, if different), reviewed by UC
	Commence preparation of necessary financial statements	CO, A
	Draft powers of attorney for registration statement and amendments thereto, if needed (these will typically be contained in signature page of registration statement)	CO, CC
	Select banknote company to print stock certificates	CO, CC
	Advise banknote company of schedule and arrange for printing of stock certificates	CO
	Select transfer agent and registrar	CO
	Select financial printer	CO, CC
	If desired, exchange letter of intent with issuer	CO and UW, reviewed by CC and UC
	If desired, draft and distribute press release announcing proposed offering (see Rule 135 and appropriate SEC releases)	CO and UW, reviewed by CC and UC
	Determine possible reservation of securities for employees and business associates of the company	CO, UW

Date	Activity	Participants
	Distribute first draft of registration statement	CO, CC
	File Form ID with SEC to reserve electronic filing codes	CO or CC
	Determine availability and reserve desired stock exchange trading symbol	CO, CC
	First meeting to discuss registration statement	CO, CC, UW, UC, A
	Distribute underwriting documents	UW, UC
	Commence negotiations with lenders and lessors concerning necessary consents and revisions of covenants that would restrict offering, use of proceeds thereof or dividends	CO, CC
	Contact stock exchange regarding preclearance; file stock exchange application	CC
	Revise and distribute registration statement	CO, CC
Week Four	Revise and distribute registration statement	CO, CC
	Distribute drafts of financial statements ²	CO, A
Week Five	Second meeting to discuss registration statement and underwriting agreement	CO, CC, UW, UC, A
	Discuss comfort letter content and procedures	UC, UW, A
	Review and approve proofs of stock certificates	CO, CC
	Obtain completed questionnaires and powers of attorney, if any, from officers, directors and 5% or more stockholders of company	CO or CC
	Obtain completed initial reports of beneficial ownership (Form 3) from officers, directors and 10% or more stockholders of company	CO or CC
	Revise and distribute registration statement	CO, CC
	Assemble exhibits and deliver electronic version to printer	CO, CC

¹ A separate Agreement Among Underwriters, Underwriters' Questionnaire and Underwriters' Power of Attorney will not be required if a Master Agreement Among Underwriters is applicable to the offering. Different underwriters have different forms of these agreements. Consult with the lead underwriter as to the proper form(s).

² The timing of the release of the financial statements will vary, depending on the proximity of the commencement of preparation of the registration statement to the end of the fiscal quarter for which financial statements are to be included in the registration statement.

Date	Activity	Participants
Week Six	Third meeting to discuss registration statement and underwriting agreement	CO, CC, UW, UC, A
	Draft of registration statement to printer	CC
	Draft of underwriting agreement to printer	UC
	Finalize and circulate “corporate cleanup” and recapitalization documents	CO, CC
	Ensure that company has obtained the necessary authorizations and approvals of the offering from regulatory agencies, if any	CO, CC
	Circulate draft of comfort letter	A
	Prepare Form 8-A for Exchange Act registration	CO, CC
	Determine possible reservation of securities for employees and business associates of company	CO, UW
	Arrange to have execution copies of the signature pages printed and signed by necessary officers and directors (these pages may, if acceptable to the persons signing, include designations of certain individuals to sign amendments to the registration statement as attorneys-in-fact on their behalf) [Note: If submitted pursuant to the confidential submission process, registration statement that is submitted need not be signed. Official filing with SEC must be signed (at least 15 days before road show).]	CO and CC
	Arrange to have execution pages for accountant’s opinions and consents delivered, executed and returned in time for filing [Note: If following the confidential submission process, the audit report must be signed but consents need not be provided until the official filing with the SEC (must be signed at least 15 days before road show).]	CC and A
Arrange for consents of persons about to become directors, if required (see Rule 438 under the Securities Act)	CC	

Date	Activity	Participants
Week Seven	Finalize and execute powers of attorney and custody agreements and arrange for placement of selling shareholders’ stock certificates with custodian prior to filing with SEC, if necessary (custodian is often the transfer agent and registrar)	CO, CC
	Confirm approval for stock exchange	CO, CC
	Meetings at printer to discuss and finalize registration statement	CO, CC, UW, UC, A
	Circulate revised proofs of registration statement and underwriting agreement	CC, UC
	Meeting of board of directors of company to approve financing program and “corporate cleanup” matters, including adoption of resolutions relating to:	CO, CC
	(a) Authorization of issuance, sale and delivery of stock	
	(b) Participation by selling shareholder(s), if applicable	
	(c) Approving form of underwriting agreement and authorizing execution and delivery thereof	
	(d) If necessary, appointing a special committee of the board of directors to establish the price of stock to the underwriters and the initial public offering price	
	(e) Approving registration statement and prospectus and authorizing execution and filing of registration statement and all amendments thereto	
	(f) Authorizing listing of stock on stock exchange	
	(g) Appointment of transfer agent and registrar	
	(h) Approving all necessary “corporate cleanup” matters	
(i) Approving recapitalization, if necessary		
(j) Calling a special meeting of stockholders, if necessary		
(k) Approving form of stock certificates		

Date	Activity	Participants	Date	Activity	Participants
	(l) Blue sky matters			Otherwise, file registration statement with SEC via EDGAR	
	Special meeting (or written consent in lieu of meeting) of stockholders of company, at which resolutions are adopted, approving any recapitalization and all “corporate cleanup” matters requiring stockholder approval [Note: This may be done later in the process if following confidential submission process, after official filing is made and offering becomes public.]	CO, CC		File Form 8-A with SEC via EDGAR, and with stock exchange on which listing is sought [Note: This would be deferred to official filing, if following the confidential submission process.]	CC
	File charter amendments necessary to effect recapitalization, if applicable [Note: This may be done later in the process if following confidential submission process, after official filing is made and offering becomes public.]	CO, CC		File registration statement and related materials with FINRA and stock exchange	UC
	Finalize financial statements	CO, A		Notify parties that filing is accomplished and specify the SEC registration number (if any)	CC or UC
	Finalize underwriting agreement	CO, CC, UW, UC	Week Eight	If appropriate, issue brief press release re filing of registration statement (See Rule 134) [Note: This would be deferred to official filing, if following the confidential submission process.]	CO, UW
	Notify stock exchange at least two business days prior to expected filing date for stock exchange approval	CC		Have copies of registration statement distributed to company, company counsel, auditors, underwriters and underwriters’ counsel	CO or CC
	Give instructions to printer with respect to the mailing of preliminary materials	UW		Prepare application for CUSIP number, apply for CUSIP number for stock; send copy of registration statement to CUSIP Service Bureau	CO, CC
	Determine quantities of preliminary offering materials required and give printer instructions re same	CO, UW, UC		Send copies of registration statement to FINRA and stock exchange	CO, CC
	Finalize compilation and preparation of exhibits to registration statement	CO, CC	Week Nine	File documents and otherwise finalize arrangements with transfer agent and registrar necessary for its initial appointment	CO, CC
	Obtain approval letter from stock exchange	CO, CC		Obtain CUSIP number for stock	CO, CC
	Prepare transmittal letter to FINRA	UC		Approve final proof of stock certificates	CO, CC
	Complete blue sky survey	UC		Order closing documents with long lead times	CC
	Finalize comfort letter	UW, A, UC		Resolve outstanding issues with FINRA and blue sky administrators	UC
	Arrange for wire transfer of SEC filing fee [Note: Fee not due until official public filing, if following confidential submission process.]	CO		Resolve issues with stock exchange	CO, CC
	Obtain certified or cashier’s check for FINRA and stock exchange filing fees	CO, CC	Weeks Eleven through Seventeen	Receive comments from SEC ³	CC
	If following confidential submission process, submit registration to SEC on confidential basis.	CC			

³ Estimated time frame for receipt of SEC comments. To the extent that the SEC’s comments are received significantly before or after the assumed date, the subsequent dates would be adjusted accordingly.

Date	Activity	Participants
	Review SEC comments and draft changes to registration statement in response thereto; clear responses to comment letter and schedule for filing/submission of amendment to, and effectiveness of, registration statement (and Form 8-A) with SEC (SEC may require two or more amendments containing changes to be filed prior to the final amendment)	CO, CC, UW, UC, A
	Note: If following the confidential submission process, the official filing of the registration statement must be made at least 15 days prior to commencement of road show. Upon making the official filing, complete tasks that had previously been deferred until the offering became public (see above)	CO, CC, UW, UC, A
	Print preliminary prospectuses in quantity	CO
	Commence information meetings (“road show”)	CO, UW
Week Eighteen	If the amended preliminary prospectus incorporates substantial changes from prior distributed preliminary prospectus, consider recirculating preliminary prospectus	CC, UC
	Obtain FINRA clearance of underwriting arrangements	UW, UC
	Prepare requests for acceleration of effective date of registration statement (see Rule 461) and Form 8-A	CO, CC, UW, UC
	Obtain letter from underwriters joining in company’s request for acceleration of effectiveness of Form 8-A	CO, CC
	Distribute initial draft of closing memorandum	UC
	Notify stock exchange of expected effective date of registration statement no less than 72 hours prior to anticipated effectiveness	CO, CC

Date	Activity	Participants
	File acceleration request of company to SEC at least two business days in advance of desired effective date, together with letter of managing underwriter(s) joining in such request and providing information concerning distribution of preliminary prospectuses (see Rule 15c2-8 under the Exchange Act and Release No. 33-4968)	CC, UC
	File letter with SEC and stock exchange requesting acceleration of effective date of Form 8-A	CC
	Complete road show	CO, UW
Week Nineteen	Registration statement declared effective by SEC (5:00 p.m., Eastern Time) ⁴	CC
	Form 8-A declared effective (5:00 p.m., Eastern Time)	CC
	Underwriter notified of effectiveness	CC
	Stock exchange notified of effectiveness of registration statement and Form 8-A	CC
	Notify syndicate of effectiveness	UW
	Meeting of company’s board of directors (or special committee of the board of directors) to establish the price of stock to the underwriters and the initial public offering price thereof and to approve final form of underwriting agreement	CO, CC
	Prepare “tombstone” advertisement	UW, UC
	Give printer labels and mailing instructions for final prospectus	UW
	Deliver comfort letter (5:00 p.m., Eastern Time)	A
	Sign underwriting agreement (5:30 p.m., Eastern Time)	CO, UW
	File initial reports of beneficial ownership (Form 3) on behalf of officers, directors and 10% or more shareholders of company as of the date of effectiveness (may be pre-filed)	CC
	Prepare final prospectus containing pricing information (Rules 424(b) and 430A)	CC, UC

⁴ Earlier effective time may be requested. If so, times listed above and time of effectiveness of Form 8-A should be appropriately adjusted.

Date	Activity	Participants
Offering Day (day after pricing)	Issue press release re effectiveness of registration statement and price of stock	CO, UW
	File final prospectus with SEC pursuant to Rule 424(b)	CC
	Deliver copy of final prospectus to FINRA	UC
	Deliver copy of final prospectus to stock exchange	CC
	Release “tombstone”	UW
	Begin market-making activities	UW
	Distribute revised draft of closing memorandum	UC
	Commence preparation of legal opinions, certificates and other closing documents	UC, CC, TA
	Contact banknote company to arrange for printing in quantity of stock certificates	CO
	Print final prospectus in quantity	CO
	File Form S-8 to register stock issuable pursuant to employee benefit plans	CO, CC
Day After Offering Day	“Tombstone” advertisement appears	UW
	Notify syndicate of closing date and give instructions re payment	UW
3 Days Prior to Closing	Furnish company and transfer agent and registrar with names and denominations in which stock certificates are to be registered	UW
	Company counsel opinion and instructions for certificates to transfer agent and registrar	CO, CC
1 Day Prior to Closing	Preliminary closing (2:00 p.m., Eastern Time)	CO, CC, UC
	Stock certificates packaged for closing	UW, TA
Closing Day	Closing (9:00 a.m., Eastern Time)	CO, CC, UW, UC, TA
Post-Closing, as Appropriate	Monitor undertakings in registration statement for compliance	CC
	Prepare bound volumes	CC

Date	Activity	Participants
Within 45 Days from the End of the First Fiscal Quarter Ending After Effective Date of Registration Statement	File report on Form 10-Q with SEC	CO, CC, A
	File report on Form 10-K with SEC re offering expenses and use of proceeds	CO, CC, A
Within 90 Days from the End of the Fiscal Year Ending After the Effective Date of the Registration Statement	File report on Form 10-K with SEC re offering expenses and use of proceeds	CO, CC, A
	Provide underwriters with copies of filings as agreed upon in underwriting agreement	CO, CC
Various Dates Subsequent to Effective Date of Registration Statement	Provide underwriters with copies of filings as agreed upon in underwriting agreement	CO, CC

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Navigate the IPO disclosure process with confidence.

Discover the benefits of working with a document management leader. From pre-IPO due diligence, through the SEC registration process to post-IPO disclosure support, Merrill is with you every step of the way. Our project management teams will help you optimize collaboration among dispersed working groups; streamline the review, drafting and filing of documents; speed transaction times and ensure maximum cost-efficiency.

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Merrill Bridge™ for pre-IPO document drafting and collaboration, and post-IPO SEC disclosure management.

Preparation for an IPO requires working groups to draft and collaborate on an extensive set of documents over many sessions and typically from many locations. The ability for the key stakeholders to simultaneously access, edit and review documents from a single source can significantly increase the speed in which companies access the capital markets. Merrill Bridge provides the document editing and content management features of Microsoft® Word and the powerful data management capabilities of Microsoft® Excel® (with enhanced data linking), all tightly integrated into a team-based workflow. Leveraging Merrill Bridge for pre-IPO document drafting and collaboration allows you to seamlessly transition to post-IPO SEC reporting requirements including the creation and submission of EDGAR and XBRL instance documents.

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REPRESENTATIVE MERRILL LOCATIONS

PACIFIC NORTHWEST, UNITED STATES
1420 5TH AVENUE, SUITE 3250
SEATTLE, WA 98101

EUROPEAN HEADQUARTERS
101 FINSBURY PAVEMENT
LONDON EC2A 1ER ENGLAND

EAST COAST, UNITED STATES
1345 AVENUE OF THE AMERICAS, 17TH FLOOR
NEW YORK, NY 10105

ASIAN HEADQUARTERS
5TH FLOOR, WORLDWIDE HOUSE
19 DES VOEUX ROAD CENTRAL HONG KONG