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The IPO: Overview and Guide

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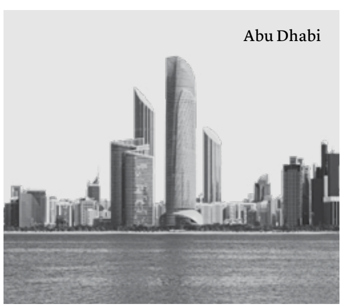
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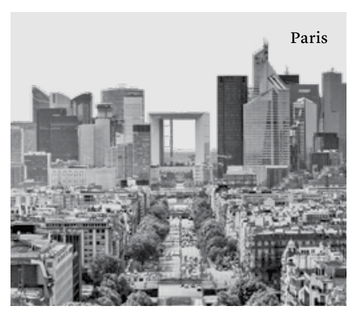
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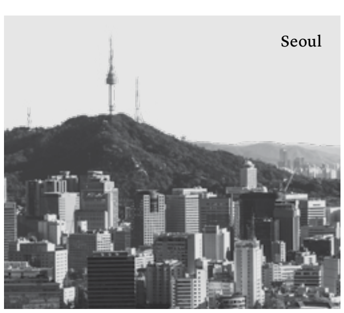
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Introduction

Once a company registers with the U.S. Securities and Exchange Commission (SEC), it has access to the largest public capital markets in the world. As options for private financing have grown, though, many companies now wait longer before an initial public offering (IPO). Between 2010 and 2021, companies that went public were about ten years old on average; during the dot-com bubble in 1999–2000, that average was five.[1] At the same time, and despite recent market volatility, a debut on the public markets remains a popular goal and a significant milestone in the life of a company.

This Overview and Guide provides an introduction to the SEC registration process, with a particular focus on IPOs. First, it covers options for pre-IPO financing and the reasons why a company might go public. The Overview and Guide then describes the IPO process and some of the requirements that public companies face. Finally, it examines financing alternatives for a public company and its shareholders.

[1] Jay Ritter, *Initial Public Offerings: Median Age of IPOs Through 2021* (Feb. 16, 2022) [hereinafter Ritter 2021 IPO Report].

Pre-IPO Financing

As companies stay private longer, the number of IPOs in the United States has decreased over time. From 1990 to 1999, there were 5,724 IPOs on U.S. exchanges. Between 2000 and 2009, there were 2,106 IPOs in the United States and 2,163 from 2010 to 2019.[2] What IPOs have lost in number, though, they have made up in size. Between 1990 and 1999, U.S. IPOs raised $482 billion.[3] Between 2000 and 2010—when the number of U.S. IPOs decreased by 63%—total deal value increased to $569 billion.[4] The next ten years saw a marginal increase in that amount, followed by a record-breaking year in 2021 and a significant slow-down in 2022 and the first three quarters of 2023.[5] In general, the companies that go public now are older, larger, and more mature.[6]

Companies are waiting longer to go public for a few reasons: the availability of pre-IPO private financing, the existence of pre-IPO secondary markets for shareholders, the mixed performance of some IPOs,[7] and a sharper focus on profitability. Private companies can take more risks without criticism from public shareholders. They avoid the scrutiny of research analysts and the burden of quarterly reporting, as well as pressure from public market investors on profitability and corporate governance.[8] While private, companies can still offer liquidity to shareholders by using third-party service providers to facilitate tender offers and share buybacks. By waiting longer to go public, a company may become more developed—and its valuation will show it. Finally, periods of volatility in the stock markets can make timing and pricing a public offering challenging. As rising inflation, higher interest rates. and geopolitical conflict caused uncertainty and volatility in the stock markets, the number of U.S. IPOs decreased dramatically in 2022. Although the first three quarters of 2023 have shown some signs of improvement, the market remains highly selective.[9]

Companies may also stay private longer because they have many options for private financing. In 2012, the Jumpstart Our Business Startups (JOBS) Act eased requirements for private placements. These provisions include the following:

— The increase of the mandatory registration threshold for a class of securities under the Securities Exchange Act of 1934, as amended (the "Exchange Act") from 500 record holders to 2,000, so long as fewer than 500 of those holders are not accredited investors. This threshold excludes certain categories of holders, including persons who received securities under employee compensation plans in transactions exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"). This change allows pre-IPO companies to grant equity compensation to their employees without inadvertently becoming reporting issuers under the Exchange Act.

— The allowance of general solicitation and advertising for certain securities placements under Regulation D.

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2 Preston Brewer, *Analysis: Three Decades of IPO Deals (1990-2019)*, BLOOMBERG LAW (Jan. 9, 2020).

3 *See id.*

4 *See id*.

5 In 2021, 416 U.S. IPOs raised $155.8 billion in proceeds, representing increases of 86% in number and 81% in proceeds from 2020. In 2022, however, 90 U.S. IPOs raised $8.6 billion in proceeds, representing decreases of 78% in number and 94% in proceeds from 2021. *See* Ernst & Young Global Limited, EY Global IPO Trends, 2021 Q4 [hereinafter E&Y 2021 IPO Report], at 12. The first three quarters of 2023 surpassed full-year 2022 levels, with 100 U.S. IPOs raising $18.6 billion of total proceeds. See Ernst & Young Global Limited, Hope Returns to the IPO Market as Recent Deals Test Investor Sentiment (Oct. 18, 2023).

6 *See generally*, Ritter 2021 IPO Report, *supra* note 1.

7 *See* Corrie Driebusch, *The IPO Market Is Open Again! At Least for the Moment.*, WALL ST. J. (Sept. 24, 2023) (describing the poor aftermarket performance of recent IPOs).

8 *See* Maureen Farrell, *2019: The Year of IPO Disappointment*, WALL ST. J. (Dec. 29, 2019).

9 *See* Corrie Driebusch, *IPO Market Faces Worst Year in Two Decades*, WALL ST. J. (Aug. 22, 2022).

Under these relaxed publicity requirements, issuers can reach more investors. This change has also led to the growth of crowdfunding platforms for accredited investors.

— The introduction of Regulation A+.[10] Companies can raise up to $75 million through securities offerings in a twelve-month period, subject to a lighter disclosure and reporting regime than would otherwise apply.

— The creation of a crowdfunding framework for retail investors, for which SEC registration is not required.

[10] *See* Rules 251 through 263 under the Securities Act.

Advantages of Going Public

If and when a company goes public, it may do so for these reasons.

Raising Capital

The most common reason for an IPO is to raise money. After registering its offering with the SEC, a company can sell its stock to all kinds of investors in the United States, including retail investors. An IPO provides an issuer with both initial financing (to the extent it is a primary offering) and access to the public markets for future funding. Once a company is listed on a securities exchange, such as the New York Stock Exchange (NYSE) or Nasdaq Stock Market (NASDAQ), it can also raise money again in the future.

Venture Capital or Private Equity Exits

Venture capital and private equity sponsors typically want to exit their positions in companies after a certain number of years. They can do so through either an acquisition or a public offering and gradual sell-down. A sponsor might pursue both options simultaneously in a so-called "dual-track" process. While the company prepares to go public, the possibility of its IPO also motivates potential acquirers to move quickly. The IPO process gives the sponsor an approximate valuation of the company that it can compare to bids from potential acquirers. IPOs by sponsor-backed companies historically have been common. In 2022, however, private equity- or venture capital-sponsored IPOs shrunk to a 20-year low and accounted for only 5% of the total number of IPOs.[11]

Founder Liquidity

An IPO offers liquidity not only to sponsors, but also to company founders. Even if the founders do not sell their shares in the IPO, going public allows them to sell some or all of their stake in the company over time.

Employee Compensation

Going public enables a company to give equity to its employees as a form of compensation. When employees receive equity-based compensation, they may be more invested in the long-term financial success of the company.

Acquisition Currency

Public stock can be used as a currency for acquisitions. The company can use its stock to buy other companies along with, or instead of, cash.

Prestige and Branding

Going public is a major event in the life of a company. An IPO shows that a company is ready to withstand the scrutiny of public markets and that it has the infrastructure to do so: sufficiently large and sophisticated accounting, finance, compliance, legal, and investor relations (IR) functions; strong internal and disclosure controls; and good governance and compliance practices. A successful arrival at this prestigious milestone can also be a significant branding opportunity.

[11] E&Y 2021 IPO Report, *supra* note 5, at 12.

Disadvantages of Going Public

Though IPOs have many benefits, they also bring the following costs and considerations for companies.

Increased Expenses

The IPO process can be expensive. Legal and accounting fees for the transaction can be several million dollars. Once public, a company must complete required audits of its internal control over financial reporting. Disclosure requirements in many areas have become more complex over time, from executive compensation to the use of "conflict minerals." To meet these obligations, a company will continue to incur legal, accounting, compliance, and other costs every year, often on a significant scale, depending on the company's size, industry, and location.[12]

Because of recent major hacks on a number of public companies, the SEC has also focused more closely on cybersecurity. In July 2023, the SEC adopted rules that would require public companies to disclose (i) material cybersecurity incidents on a current basis, on Form 8-K or Form 6-K, as applicable, and (ii) policies and procedures governing the risk management, strategy, and governance of cybersecurity within the organization on a periodic basis, on Forms 10-K/10-Q or Form 20-F, as applicable.[13] Even before the SEC adopted these rules, many public companies had built more robust cyber protections, both to safeguard their businesses and to insulate themselves from potential liability. Similarly, the SEC and the investor community have heightened their focus on Environmental, Social and Governance (ESG) matters (see section 1:4.6 below). As regulatory burdens continue to grow, a company preparing for an IPO should anticipate significant costs in its future.

Increased Exposure to Liability

Disclosure is critical to life as a public company. Federal and state securities laws impose a range of penalties on companies, directors, and officers for materially inaccurate or incomplete disclosure. Directors and officers also have fiduciary duties to shareholders and may face shareholder claims for breaches of those duties. Although directors and officers usually have directors' and officers' (D&O) insurance and indemnification from their companies, these measures may not protect them fully, and do not address the risks and reputational issues associated with allegations of potential securities law violations.

Loss of Privacy and Flexibility

With regular SEC reporting, coverage by research analysts, and press from financial news sites, public companies are often in the spotlight. Under the Exchange Act, U.S. issuers are required to report quarterly. Many foreign private issuers[14] also report quarterly, either to meet their home country requirements or to satisfy investors. These disclosures can provide competitors with sensitive information that a company might not otherwise release. Internal events—departures of senior management, upcoming mergers and acquisitions (M&A), financing transactions, or the loss of key business relationships—can all become news stories. Once a company is public, it must manage these events more carefully than before.

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12 Price water house Coopers LLP, *Considering an IPO? An Insight Into the Costs Post-JOBS Act*, at 5 (2015).

13 Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, Final Rule, Securities Act Release No. 33- 11216 (July 26, 2023).

14 A "foreign private issuer" is a company incorporated or organized under the laws of a foreign country unless (i) more than 50% of its outstanding voting securities are directly or indirectly owned by residents of the United States, and (ii) any one of the following: (a) the majority of its executive officers or directors are U.S. citizens or residents; (b) more than 50% of its assets are located in the United States; or (c) its business is administered principally in the United States. Securities Act Rule 405.

As the SEC responds to current events and market conditions, these disclosure requirements can also change. For example, in a May 2022 sample comment letter, the SEC instructed issuers to provide "detailed disclosure, to the extent material or otherwise required"[15] of the ways in which the ongoing conflict between Ukraine and Russia affected their businesses. A company might need to disclose actual or potential disruptions to its supply chain or its reliance on goods or services sourced in Russia or Ukraine, among other items. In December 2022, after the bankruptcy of cryptocurrency exchange FTX and widespread distress in cryptocurrency markets, the SEC also instructed issuers to consider cryptocurrency risks and exposure in their disclosures.[16] If material, exposure to cryptocurrency bankruptcies or potential losses of cryptocurrency assets would warrant disclosure, as would the effects of cryptocurrency redemptions or withdrawals on an issuer's financial condition. To remain compliant with changing disclosure requirements, public companies must monitor these developments in SEC guidance. They must be prepared to disclose risks that are material to their businesses or other matters the SEC may consider important to investors.

Because of their regular reporting obligations, public companies may find their attention directed to short-term financial results and stock price performance rather than long-term success. Some members of the financial community have even called for an end to quarterly reporting to ease the pressure to deliver short-term results, although such proposals do not seem to have gained traction.[17]

Stock buybacks are an example of this "short-termism." In recent years, companies have bought back large amounts of stock not only to return capital to investors, but also to boost stock prices and earnings per share.[18] These stock buybacks increased dramatically after the Tax Cuts and Jobs Act (TCJA) reduced corporate tax rates in 2017. After subsiding in 2020, stock buybacks increased again in 2021 and 2022.[19] Some investors have criticized these buybacks and claim they undermine the long-term health of businesses. The frequency of stock buybacks may change again soon because of new tax provisions in the Inflation Reduction Act (IRA), which was signed into law in August 2022. Under the IRA, beginning in 2023, public companies owe a 1% excise tax on the fair market value of any stock they repurchase during the taxable year.[20] In May 2023, the SEC had adopted rules that would require more detailed qualitative and quantitative disclosure from issuers, including foreign private issuers, regarding their share repurchases. The final rules require all reporting issuers to report information regarding their daily share repurchases on a quarterly basis and to disclose information about their stock buyback programs on Form 10-K or Form 10-Q, with an analogous requirement for foreign private issuers.[21] However, in November 2023, the SEC stayed the effectiveness of the final rules pending further action in response to a decision by the U.S. Court of Appeals for the Fifth Circuit that the final rules had violated certain

[15] *See* Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues (May 3, 2022).

[16] *See* Sample Letter to Companies Regarding Recent Developments in Crypto Asset Markets (Dec. 8, 2022).

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

[18] *See*, *e.g.*, *The Repurchase Revolution*, THE ECONOMIST (Sept. 13, 2014); Dan Strumpf, *Companies' Stock Buybacks Help Buoy the Market*, WALL ST. J. (Sept. 13, 2014); Karen Langley, *Buybacks Hit Record After Pulling Back in 2020*, WALL ST. J. (Dec. 12, 2021).

[19] *See*, *e.g.*, Sebastian Pellejero, *Stock-Buyback Plans Shrink*, WALL ST. J. (Mar. 9, 2020); Jessica Menton, *Slowing Share Buybacks Remove a Pillar of Stock Market*, WALL ST. J. (Aug. 21, 2019); Lu Wang, *Stock Buyback Addiction Rages Among Companies at War with Bear Market*, BLOOMBERG (Oct. 25, 2022).

[20] 26 U.S.C. § 4501 (2022).

[21] *See* Share Repurchase Disclosure Modernization, Final Rule, Exchange Act Release No. 34- 97424 (May 3, 2023).

requirements of the Administrative Procedure Act.[22] The final rules remain stayed as of December 2023.

Management Distraction

Because senior management is an integral part of the IPO working group, an IPO can distract management from other areas of the business. Once a company is public, the chief executive officer (CEO), chief financial officer (CFO), and other executive officers and directors must devote time to quarterly earnings reports, communications with public shareholders, and compliance requirements. Time spent on these activities is time not spent on the business.

Loss of Control

Selling a percentage of a company to the public usually requires the surrender of some control. Sometimes, though, companies implement dual-class stock or similar structures to keep control in the hands of a sponsor or founder. Even if a company sells only a minority of its shares to the public and insiders still control corporate voting, directors and officers must still heed their fiduciary duties to shareholders. These duties can conflict with the wishes of those sponsors, founders, and insiders. Additionally, once a company lists on a securities exchange, it is subject to corporate governance requirements that also reduce control. For example, for most public companies, the majority of the board must be independent. The board must also include independent audit, compensation, and nominating/corporate governance committees.[23]

Exposure to Governance Scrutiny and Shareholder Activism

Public companies are scrutinized not only by the SEC, but also by shareholders, activists, institutional investors, and other branches of government.

Proxy advisory services, such as Institutional Shareholder Services (ISS) and Glass Lewis, publish guidelines on various corporate topics, including governance and executive compensation. These services will advise that shareholders vote against directors that do not meet their guidelines—and their recommendations are meaningful.

Activist investors also can be a serious threat. If they believe a company is poorly run, they may stage proxy campaigns for their own proposals, such as to seize board seats. Even if a company defends itself from these attacks successfully, they are still time-consuming, expensive, and distracting.

ESG disclosures are also a frequent topic of discussion. In the last few years, public demand for ESG data has grown tremendously. Large institutional investors, including BlackRock, State Street, and Vanguard, have also made public statements in support of ESG disclosures.[24] Although most companies that have disclosed ESG data to date have used one of several common options, until now, there has been no standard ESG disclosure framework or metrics.[25]

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[22] *See Chamber of Commerce of the USA v. SEC*, 85 F.4th 760 (5th Cir. 2023); In the Matter of Share Repurchase Disclosure Modernization, Order Issuing Stay, Exchange Act Release No. 34-99011 (Nov. 22, 2023).

[23] Foreign private issuers, limited partnerships, and "controlled companies" (*i.e.*, any company of which more than 50% of the voting power for the election of its directors is held by a single person, entity, or group) are exempt from these requirements but still must have an independent audit committee. Other than audit committee requirements, a listed foreign private issuer generally is permitted to follow its home country governance practices but is required to include in its annual report on Form 20-F a description of how those practices differ from those that would apply to a U.S. issuer listed on the relevant securities exchange.

[24] *See*, *e.g.*, Blackrock, *Towards a Common Language for Sustainable Investing*, at 8 (2020); State Street, CEO's Letter on Our 2022 Proxy Voting Agenda (2022); State Street, State Street Joins Global Leaders to Address Climate Change Risk at Vatican Gathering (2019); Vanguard, INVESTMENT STEWARDSHIP 2021 SEMI-ANNUAL REPORT (2021).

[25] Commonly used frameworks include the Sustainability Accounting Standards Board (SASB) framework, the Task Force on Climate-related Financial Disclosures (TCFD) framework, and the Global Reporting Initiative (GRI) framework. *See generally* Catherine M. Clarkin et al., Sullivan & Cromwell LLP, *The Rise of Standardized ESG Disclosure Frameworks in the United States*, HARV. L. SCH. FORUM ON CORP. GOV. (June 22, 2020).

The SEC proposed rules related to climate disclosures in March 2022, following several years of discussion.[26] The proposed rules would apply to reporting companies generally, including foreign private issuers. The disclosures under the proposed rules would be required in annual reports under the Exchange Act and in registration statements under the Securities Act.

Rather than use an existing climate-related disclosure framework, the SEC proposed its own regulatory framework, based in part on the Task Force on Climate-Related Financial Disclosures (TCFD) framework and on the Greenhouse Gas (GHG) protocol. Under the proposal, once the rules are fully in effect, every annual report or registration statement would include a separate section captioned "Climate-Related Disclosure." A new part 1500 of Regulation S-K would govern the disclosures in that section, which would also include an attestation report from an independent expert. In annual reports or registration statements, audited financial statements would include a note providing "climate-related metrics," governed by a new Article 14 of Regulation S-X.[27] The proposed rules remain pending as of December 2023.[28]

In addition to climate-related risk and disclosure, gender and racial diversity are critical to discussions of management and strategy. A 2018 California state law requires that public companies with principal executive offices in California (as identified on their annual reports on Form 10-K) have at least one female director.[29] Colorado, New York, Illinois, and Maryland have enacted similar laws that require either mandatory minimums, disclosures, or both.[30] The Illinois statute requires corporate boards to disclose both gender and racial diversity statistics.[31] In September 2020, California enacted a law requiring a California-headquartered company to have at least one director on its board from an underrepresented community[32] by the end of 2021, with the required number increasing by the end of 2022 depending on the size of the board.[33] Both California laws were held to violate the Equal Protection Clause of the California Constitution by lower state and federal courts in California and, as of December 2023, remain pending on appeal.[34] Proxy advisory firm ISS has also called for companies to disclose the ethnicities of their directors on a voluntary, aggregated, self-identified basis.[35]

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[26] *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Proposed Rule, Securities Act Release No. 33 11042 (Mar. 21, 2022). After the initial comment period, the SEC reopened the comment period for these rules in October 2022 because of a technological error that had prevented the SEC from receiving a number of public comments.

[27] Compliance dates for the climate disclosure rules would vary based on registrants' filing status (that is, large accelerated, accelerated and non-accelerated filers, and smaller reporting companies).

[28] In December 2023, the SEC moved the target date for finalizing the climate disclosure rules from October 2023 to April 2024. *See* SEC, Fall 2023 Regulatory Flexibility Agenda.

[29] If the corporation has four or fewer directors, California law requires a minimum of one female director. If the corporation has five directors, a minimum of two female directors is required, and if it has six or more directors, a minimum of three female directors is required. CAL. CORP. CODE § 301.3. On April 4, 2022, however, this law was struck down by the Superior Court of California for the County of Los Angeles. *See* Crest v. Padilla, No. 20STCV37513 (Cal. Super. Ct. Apr. 1, 2022).

[30] *See* Michael Hatcher & Weldon Latham, Jackson Lewis P.C., *States Are Leading the Charge to Corporate Boards: Diversify!*, HARV. L. SCH. FORUM ON CORP. GOV. (May 12, 2020).

[31] 805 ILL. COMP. STAT. 5/8.12 (2019).

[32] The law defines a director from an underrepresented community as "an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender." Assemb. B. 979 (Cal. 2020).

[33] Companies with nine or more directors will need a minimum of three directors from underrepresented communities; companies with five to eight directors will need a minimum of two directors from underrepresented communities; and companies with four or fewer directors will need one director from an underrepresented community.

[34] *See* Sarah Fortt et al., Latham & Watkins LLP, *California Gender Board Diversity Law Is Held Unconstitutional*, HARV. L. SCH. FORUM ON CORP. GOV. (June 12, 2022) ; *see also All. for Fair Bd. Recruitment v. Weber*, E.D. Cal., No. 2:21-cv-01951 (May 16, 2023) (holding that the law violates the Equal Protection Clause of the Fourteenth Amendment of the U.S. Constitution and 42 U.S.C. § 1981).

[35] Andrew Edgecliffe-Johnson & Billy Nauman, *ISS Urges Companies to Disclose Ethnicity of Directors*, FIN. TIMES (July 12, 2020).

In August 2021, the SEC approved NADSAQ's proposed board diversity rule, which uses a "comply or disclose" approach to diversity disclosures. The rule became effective in August 2022, at which time NASDAQ-listed companies were required to complete and publish NASDAQ's matrix of board diversity data on their websites or in their proxy statements.[36] By August 2023, companies must have one diverse director or disclose why the company does not have one. By August 2025, companies must have at least two diverse directors or explain why they do not have two such directors. A "diverse" director is defined as an individual who self-identifies as female, LGBTQ+, or a member of an underrepresented racial or ethnic minority group.[37]

Valuation Fluctuation

The market determines the valuations of public companies every day. Macroeconomic and industry conditions, market sentiments, and other factors can all affect stock price, for better or worse. The impact of research analyst reports on a company's valuation can also be significant. Like the short-termism discussed above, these fluctuations can lead to undue focus on the stock price rather than on longer-term, fundamental business issues.

[36] *See* NASDAQ, Board Diversity Matrix Disclosure Requirements and Examples (Feb. 23, 2022). In October 2023, the U.S. Court of Appeals for the Fifth Circuit upheld the NASDAQ board diversity rule in the face of challenges that (among other things) the rule attempted to improperly and unconstitutionally dictate the composition of corporate boards. *See Alliance for Fair Bd. Recruitment v. SEC*, No. 21-60626, 2023 WL 6862856, at *14 (5th Cir. Oct. 18, 2023). A petition for rehearing *en banc* has been filed and remains pending as of December 2023.

[37] *See* NASDAQ Stock Market Rules 5605(f), 5606.

The IPO Working Group

After deciding to do an IPO, a company's first step is to assemble its IPO working group. The internal IPO working group typically includes the CEO, CFO, controller/treasurer, and general counsel, along with a team of outside advisors that includes bankers, lawyers, and auditors.

The selection of investment bankers is crucial. Between one and three investment banks (or sometimes more) will serve as the lead underwriters or "bookrunners." On behalf of the entire underwriting syndicate, these lead underwriters run the IPO process. They advise the company on its valuation and offering structure, market the transaction, and, most importantly, build a book of orders and price the IPO. The company might choose its lead underwriters based on its existing banking relationships, a bank's IPO experience, knowledge of the sector, buy-side relationships, size of sales force, and other factors, including how the lead underwriters' strengths complement each other (including in respect of both institutional and retail accounts). Additional underwriters or "co-managers" fill out the syndicate but are less active.

Companies sometimes hire an independent IPO adviser to provide strategic advice and help select, and assess input from, the lead underwriters. The adviser generally is compensated with a portion of the fees that the underwriters otherwise would earn, so it does not carry incremental cost to the company.

Both the company and the underwriting syndicate must have counsel. Lawyers play a key part in the IPO process by assisting in the drafting of the offering documentation and transaction agreements, coordinating with the SEC (importantly, on the SEC comment process) and other regulators, providing legal opinions, and resolving any legal issues that arise.

A sponsor may also play a significant part, even if it does not plan to sell shares in the offering. A sponsor or other significant existing shareholder will often have its own counsel to represent its interests. For example, a sponsor may be concerned with valuation, governance, and control arrangements. A sponsor may also want to address registration rights, under which it can require the company to register its shares for resale in, or after, the IPO.

The company's auditor is another important participant. The auditor will need to provide a clean audit report on the company's financial statements. It will also need to give the underwriters comfort letters regarding unaudited financial information in the offering document.

Finally, the company must choose a financial printer and a transfer agent. The financial printer will file documents with the SEC on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system and print, to the extent needed, the preliminary and final IPO prospectuses. It may also be the data room provider for due diligence. A transfer agent handles the mechanics of issuing shares when the transaction is complete.

Direct Listings

Direct listings are a more recent development in the IPO market, in which the working group looks a bit different. In a direct listing, the company does not hire underwriters to sell shares on its behalf. Rather, the company lists its own shares for sale directly on the market.

The advantages of a direct listing are lower fees for the company and more immediate liquidity for shareholders. First, without the need to pay underwriters' fees, companies save on costs. While companies still hire investment banks to advise on the deal, overall advisory fees in a direct listing are much lower than typical IPO underwriting fees.[38] Second, in a direct listing, existing shareholders can sell their shares immediately if they choose. In a traditional IPO, existing shareholders are generally subject to "lock-up" agreements that prevent them from selling shares, typically for 180 days.

Until recently, a direct listing could be a secondary offering only. Companies could list only their existing shares for sale, not issue new shares to raise capital. As a result, while direct listings created liquidity for existing shareholders, they did not raise any money for the company. In December 2020, though, the SEC approved a proposal from the NYSE to allow direct primary listings in which companies can issue new shares and raise capital. In May 2021, the SEC approved a similar proposal from NASDAQ. Though no company has done a primary direct listing,[39] it is now a possibility.

Because direct listings do not involve underwriters, they may be feasible only for large, well-known companies that need not rely on underwriters to promote their offerings.[40] Notable examples of direct listings (all of which were secondary offerings) are the debuts of Spotify Technology S.A. (2018), Slack Technologies, Inc. (2019), Palantir Technologies Inc. (2020), Coinbase Global, Inc. (2021), and Warby Parker Inc. (2021). Smaller companies may not enjoy the same success if the market is not already familiar with them. Investor advocates have also questioned whether direct listings put investors at risk because of the absence of traditional price-setting mechanisms and lack of liability for misstatements and omissions that underwriters usually bear.[41] Though still relatively new, direct listings may become more common as more private companies evaluate the option.[42]

[38] For example, Lyft, Inc. spent about $70 million in underwriting fees on its traditional IPO, while Spotify Technology S.A. paid about $36 million in investment banking advisory fees for its 2018 direct listing. *See* Maureen Farrell & Ana Rivas, *The IPO Shortcut: A Direct Listing*, WALL ST. J. (June 19, 2019).

[39] As of December 2023.

[40] *See* Joseph Grundfest, *What Are Direct Listings, How Do They Work, and Why Do They Matter?* STAN. L. SCH. BLOGS (Jan. 20, 2020).

[41] *See* Alexander Osipovich, *Investor Advocates See Risks in Silicon Valley's Favorite IPO Alternative*, WALL ST. J. (Jan. 3, 2020).

[42] Companies must still consider the risk of liability under section 11 of the Securities Act in connection with direct listings. Under the Ninth Circuit's decision in Pirani v. Slack Techs, Inc., No. 20-16419, 2021 WL 4258835 (9th Cir. Sept. 20, 2021), issuers may face future securities fraud liability under section 11 in connection with direct listings, regardless of whether the plaintiffs can show they purchased registered shares. *See* Cleary Gottlieb, Divided Ninth Circuit Finds Securities Act Standing for Purchasers in Slack's Direct Listing (Sept. 30, 2021).

SPACs

Though traditional IPOs are the focus of this Overview and Guide, the recent rise of special purpose acquisition company ("SPAC") IPOs is important to acknowledge.

A private company may also choose to go public through a merger or similar transaction with an already public SPAC (a "de-SPAC" transaction). The SPAC is formed as a "blank-check" company without any commercial operations. The SPAC then goes public through an IPO process, in which it sells "units" to investors. Those units consist of a share and a warrant. After that IPO process, the SPAC has about two years to find and merge with a private target company—or return the money it received from investors.

A company may choose to go public through a SPAC because the process moves much more quickly than that of a traditional IPO. While the traditional IPO process often takes at least six to nine months, a private target company can merge with a SPAC to become a public company within a matter of three to five months. These shorter timelines mean companies bear less risk of changes in the market during their IPO process.

Though SPACs were rare until 2019, use of SPACs increased dramatically in 2020 and 2021. In 2020, there were 248 SPAC IPOs in the United States. Those 248 SPAC IPOs raised a total of $83 billion in proceeds. In 2021, there were 613 SPAC IPOs, raising about $163 billion in proceeds.[43] In 2022, there were 86 SPAC IPOs, raising about $13 billion in proceeds. In 2021, however, the SEC began to scrutinize SPACs more closely (including in respect of certain key accounting issues), and in March 2022, the SEC proposed rules that would require significantly enhanced disclosures in IPOs by SPACs and in de-SPAC business combination transactions.[44] The proposed rules remain pending as of December 2023.[45] Since the proposal was issued, however, changing market conditions and the prospect of overhauled SPAC regulation have chilled the SPAC market substantially.[46]

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[43] *See* SPAC ANALYTICS, SPAC AND US IPO ACTIVITY (Dec. 31, 2022).

[44] *See, e.g.*, Draft Recommendations of the Investor as Purchaser and Investor as Owner Subcommittees of the SEC Investor Advisory Committee Regarding Special Purpose Acquisition Companies (Aug. 26, 2021); Gary Gensler, Prepared Remarks Before the Investor Advisory Committee (Sept. 9, 2021); Special Purpose Acquisition Companies, Shell Companies, and Projections, Proposed Rule, Securities Act Release No. 33-11048 (Mar. 30, 2022).

[45] In December 2023, the SEC moved the target date for finalizing the SPAC rules from October 2023 to April 2024. See SEC, Fall 2023 Regulatory Flexibility Agenda.

[46] *See Matthew Goldstein, SPACs Were All the Rage. Now, Not So Much*, N.Y. TIMES (June 2, 2022).

EGC Status

In 2012, the JOBS Act defined the emerging growth company (EGC), a new category of company entitled to special regulatory treatment. An EGC is a company with total annual gross revenues of less than $1.235 billion (top-line revenues under U.S. Generally Accepted Accounting Principles (U.S. GAAP) or, for foreign private issuers, International Financial Reporting Standards (IFRS)).[47] A company remains an EGC until (i) the last day of the financial year five years after its common stock IPO, (ii) the last day of the financial year in which it has total annual gross revenues of $1.235 billion or more, (iii) the date on which it has issued more than $1 billion in non-convertible debt securities (whether SEC registered or not) during the preceding three years, or (iv) the date it becomes a "large accelerated filer" (generally, a company with a public float of at least $700 million that has been publicly reporting for at least one year).[48]

EGCs benefit from more liberal requirements in many parts of the IPO process. The first is disclosures and auditing. While non-EGCs must include three years of audited financial statements in a prospectus, EGCs may exclude the earliest of those three years. An EGC may also include only two years of data in its Management's Discussion and Analysis (MD&A) of results of operations and financial condition, instead of the usual three. If the third year is available, though, an EGC may still want to include it to help market the offering. In addition to relief from other accounting requirements, an EGC does not need an independent audit of its assessment of internal control over financial reporting.

EGCs also enjoy fewer disclosure requirements related to executive compensation. Non-EGCs must disclose the compensation of five named executive officers (the CEO, CFO, and next three most highly paid executive officers), but an EGC must disclose the compensation of only three (the CEO and next two most highly paid). Because EGCs are also not required to have a Compensation Discussion and Analysis (CD&A) section in the prospectus, they avoid additional detailed disclosures. EGCs are exempt from the requirements (i) to hold a non binding shareholder vote on executive compensation arrangements ("say-on-pay" and "say-on-golden parachute" provisions), and (ii) to disclose "pay versus-performance" information, including the relationship between executive compensation and the company's financial performance, and the median total compensation of all employees as compared to the CEO.

EGCs were the first category of company permitted to file "substantially complete" registration statements confidentially with the SEC. The ability to file and correspond confidentially with the SEC is quite valuable, particularly in a dual-track process, where a company can readily toggle between an IPO launch or a M&A sale. The company can then prepare for an IPO without the need to disclose any information if it is bought before public disclosures are required. If a company goes through confidential review, the working group should plan the deal timeline carefully. SEC rules require the registration statement to be made public at least fifteen days before the road show for the IPO starts.

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[47] The original revenue threshold for an EGC was $1 billion in annual revenue. The SEC adjusted this number for inflation to $1.07 billion in 2017, and will continue to index this threshold for inflation every five years, as required by the JOBS Act.

[48] *See* Securities Act § 2(a)(19).

EGCs were also the first companies permitted to "test the waters" with early investor meetings.[49] The SEC has since extended both of these abilities to all issuers.[50] When a company "tests the waters," the company or its underwriters can meet with certain potential investors to gauge their early interest in the deal. These meetings can happen even before the company files its registration statement with the SEC, or after filing but before it has a preliminary prospectus with a price range. The SEC may ask to review a company's "testing the waters" materials, however, and issuers are liable for the statements they contain.[51] For that reason, companies must weigh the benefits of outreach to investors against the risks of disclosure liability. Issuers may also want to wait to speak with investors until later in the offering process, when investors might spend more time with them .

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[49] In 2019, the SEC introduced Securities Act Rule 163B, which permits all issuers, not just EGCs, to test the waters with potential investors. *See* Securities Act Rule 163B.

[50] Foreign private issuers may choose to abide by the confidential filing regime historically available just to them, or to submit draft registrations confidentially under the new regime available to all issuers. *See* Announcement, Draft Registration Statement Processing Procedures Expanded (June 29, 2017), https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded.

[51] Companies should also take care to ensure the accuracy and conformity of these statements to what is proposed to be, or is, in the draft registration statement.

Terms of the Offering

Many variables affect the size and price of an IPO, and whether to include a primary component (to raise capital), a secondary component (sales by existing shareholders), or both. The company and lead underwriters determine a target valuation for the company by analyzing its historical and projected financial performance, business, management, and comparisons to publicly traded peers, as well as buy-side input, industry factors, and market and macroeconomic conditions. The company and lead underwriters consider the company's current and near-term financing needs, the performance of other recent IPOs (especially those of peer companies), competitors' potential IPO plans, and other significant market activity. They assess how much control the existing owners are willing to cede to the public, how much money the owners seek to raise, and how much dilution the company should incur.

The company and lead underwriters also evaluate whether the IPO structure leaves a significant amount of "overhang" in place. Overhang refers to unsold shares of a company that can depress the stock price because of an expectation that those shares will soon be sold. Because existing shareholders, directors, and officers (to the extent they do not sell in the IPO) usually cannot sell for 180 days or more after the offering, overhang is a particularly acute concern at the end of that "lock-up" period. Companies sometimes stagger the terminations of lock-up restrictions to mitigate this risk.

Last, some IPOs include directed share programs, in which the company reserves a percentage of the IPO share allocations (normally 5% or less) for "friends and family." When administering a directed share program, the company and underwriters must take care to ensure compliance with the relevant communication rules.

Accounting and Auditing Issues

In general, SEC rules require that a registration statement include the company's audited financial statements, as well as financial information for any significant business the company acquired during or after the end of its most recent fiscal year, and other entities in which the company has significant equity investments but not majority control.[52] When a significant acquisition or disposition has happened or will probably happen, the company must generally provide pro forma financial information. The pro forma statements show what certain balance sheet and income statement line items would have been if the transaction had happened at the beginning of the fiscal year or period. If the company cannot provide these audited financial statements, it cannot proceed with the offering. In addition, companies in certain industries (mining, natural resources, and banking, among others) must provide certain supplemental financial and business information.

A non-EGC will prepare a prospectus with three years of audited income statements, cash flow statements, and statements of shareholders' equity and two years of balance sheet data. As discussed, an EGC may exclude the earliest of the three years. The prospectus must also include unaudited (but reviewed) financial information for any relevant subsequent interim period, together with corresponding information for the same period in the prior year. The number of years of financial statements for any acquired business depends on the significance of the acquisition. The SEC generally will not review a registration statement or declare it effective unless the financial statements are sufficiently current in accordance with SEC rules and kept current throughout the registration process.[53] The financial statements must be prepared under U.S. GAAP or, for a foreign private issuer, IFRS as issued by the International Accounting Standards Board (IASB), or otherwise reconciled to U.S. GAAP.

The SEC may focus on many accounting issues in its review. Some examples include the need to change accounting policies to comply with U.S. GAAP, including segment reporting; the granting of "cheap" (below fair value) stock to insiders or employees, for which the SEC might require the company to expense the undervalued grant and revise its financial statements significantly; overly aggressive revenue recognition or other accounting policies; and any improper impairment or treatment of goodwill or other intangibles.

The auditor of the company's financial statements must be registered with the Public Company Accounting and Oversight Board (PCAOB) and "independent" of the company, as defined by SEC rules and PCAOB standards. If the auditor does not meet these requirements, the company must hire a new accounting firm to audit the financial statements in its registration statement (with, typically, a consequent significant delay in the IPO preparation process).

52 In the case of certain very significant acquisitions that have become probable, inclusion of the financial statements of the entity to be acquired is required (*i.e.*, even before the transaction completes). In the context of a debt offering, audited financial statements of guarantors of the securities generally must be included, subject to certain exceptions allowing condensed consolidating information for the guarantors where the issuer is a parent company offering securities guaranteed by wholly owned subsidiaries, or the issuer is a wholly owned subsidiary offering securities guaranteed by its parent and other wholly owned subsidiaries. These rules were modified relatively recently. *See* Cleary Gottlieb, New SEC Rules on Guaranteed and Collateralized Securities (Mar. 17, 2020).

53 In some cases, the SEC may review draft registration statements with certain financial information omitted. *See* Cleary Gottlieb, SEC Clarifies What Financial Information Companies Can Omit From Draft Registration Statements (Aug. 21, 2017).

Listing Venue

The NYSE and NASDAQ are the dominant U.S. securities exchanges in both market share and prestige. Governance rules for listed companies on the two exchanges are similar. As a result, a company's choice between them may come down to branding and marketing or, to a lesser extent, listing and ancillary fees. The NYSE has a physical trading floor and opened in 1792 (although electronic trading is a very significant part of the NYSE's market processes today). NASDAQ is an entirely electronic platform that started in 1971. Historically, the NYSE has been home to large, "blue chip" issuers, while NASDAQ attracted technology companies, but that distinction has eroded in recent years. Regardless of the exchange a company chooses, much of the trading volume in its stock may well go through a different trading venue, as brokers route orders to the location with the best price for execution.

Pre-IPO Corporate Clean-Up

Corporate Governance—Board Matters

Once the company has chosen an exchange, it should have enough directors to satisfy the exchange's independence requirements or ensure it will have enough to do so by the end of the one-year phase-in period.[54] The company will also need to ensure it has enough independent directors to serve on its audit, compensation, and nominating and governance committees (again, subject to phase-in periods of ninety days post-listing for a majority of independent committee members, and one year post-listing for full independence). The audit committee must include a member that is a financial expert or the company must explain why it does not have one.

Anti-Takeover Protections

Companies often put anti-takeover protections in place before they go public, when they can still change their governance arrangements without a need for public shareholders to approve. To find the right level of protection, a company must balance its own defensive needs with the potential opposition of proxy advisory services and investors. Reviewing guidelines issued by those services and practices of peer companies can be a useful place to start.

Some defensive measures include:

— organizing a board with staggered terms;

— permitting only the board to fill director vacancies;

— allowing the board to increase its own size;

— giving the board, in addition to shareholders, the power to amend bylaws;

— allowing removal of directors only for cause;

— removing the ability of shareholders to call special meetings;

— imposing lengthy advance notice periods for shareholder proposals or board nominations;

— eliminating shareholder action by written consent;

— allowing for the issuance of blank check preferred stock;

— prohibiting business combinations with significant shareholders absent prior board approval;

— requiring supermajority voting for business combinations not approved by the board of directors; and

— using high/low-voting structures (particularly where a group of founders wishes to retain control for a long period after the IPO), which have become recently more common.

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

As a company prepares to go public, it should also consider the following:

— ***Management Team***. Ensure the right management team is in place and determine if any hiring is needed (for example, a CFO or general counsel with public company experience).

[54] Foreign private issuers, "controlled companies," and limited partnerships are generally exempt from the requirement to have a majority independent board and from most other corporate governance requirements, other than the requirement to have an independent audit committee.

— ***Related-Party and Compensation Arrangements***. Amend or eliminate certain related-party or compensatory transactions. For example, under the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), a public company may not extend credit to directors or executive officers, so loans or similar arrangements should be unwound. Other transactions, such as excessive perks for management, will go over poorly with investors.

— ***Required Consents***. Obtain any required consents for the IPO (for example, from lenders or regulators).

— ***Organizational Documents***. Ensure that the company’s certificate of incorporation and bylaws are in good order and that it has a sufficient amount of stock authorized for the IPO and future offerings. The company may need to do a stock split or reverse stock split to price its shares similarly to comparable companies and maximize liquidity. A company might consider anti-takeover protections, as noted above, as well as other provisions that are easier to add pre-IPO: for example, a forum selection clause to require shareholder class actions and derivative lawsuits to be filed in a single court. These clauses frequently specify the Delaware Court of Chancery because of its well-developed body of corporate law and Delaware’s common use as a state of incorporation.[55]

— ***Corporate Policies***. Create appropriate policies, such as a code of ethics; a related-party transaction policy; a Foreign Corrupt Practices Act (FCPA), sanctions, and anti-money laundering policy; a whistleblower policy; an insider trading policy; and a cybersecurity risk management policy.

— ***Employment Agreements***. Enter into employment agreements with key employees and adopt an equity compensation plan appropriate for a public company.

— ***Director and Officer Insurance***. Put in place sufficient D&O insurance.

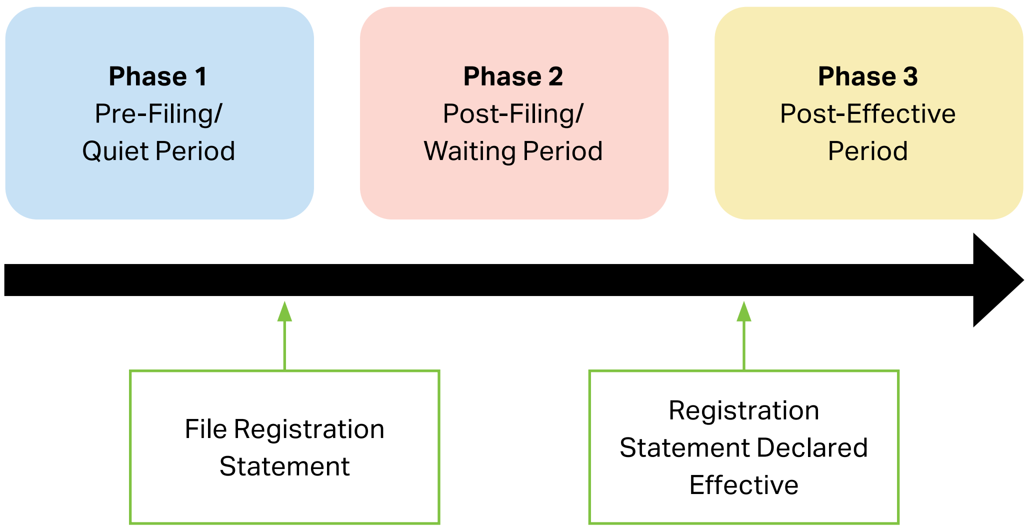
— ***Corporate Form***. Change the company’s corporate form, if necessary. An S corporation or limited liability company will often reorganize into a C corporation at the same time as an IPO.

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

Communications During an IPO

General

IPO Phases and Publicity



Throughout the IPO process, the SEC regulates and scrutinizes publicity carefully. The registration statement and the prospectus it contains are intended to be the primary source of information about the offering. The disclosures in the registration statement must be materially accurate and complete. The liability regime that applies in the case of material misstatements or omissions underscores this requirement.

Impermissible publicity, or "gun jumping," can have various consequences on an IPO. First, it can delay the transaction substantially. The SEC may require the company to wait while the effects of the publicity "cool off." Second, gun jumping can expose the company to rescission rights for investors. If an investor has rescission rights, then for a year after the IPO, it can return its securities to the company for the purchase price plus interest. In a number of high-profile IPOs, where issuer CEOs have been profiled, featured, or quoted in the press, the SEC has required the issuer to add the relevant article to its prospectus (taking potential liability therefor), along with a disclosure that investors might have rescission claims. Because these rules are so important and their consequences so significant, company counsel usually discusses publicity with senior management and the company when the IPO process starts. Throughout the process, company counsel also reviews any communications other than those made in the ordinary course of business to ensure they comply with SEC rules.

There are three phases of publicity and permitted activity in an IPO:

— ***Pre-filing, or Quiet, Period***. The most restrictive period, which begins when the company has decided to make an offering but has not yet filed a public registration statement. (A confidential filing by an issuer does not end the quiet period.)

— ***Post-filing, or Waiting, Period***. This period begins when the company files its public registration statement and ends when the SEC declares its registration statement effective.

— ***Post-effective Period***. This period begins once the SEC declares the registration statement effective.

Pre-Filing (or Quiet) Period

During the quiet period, no offers or sales are permitted. "Offer" is defined broadly as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security for value."[56] Any information can be an offer if it is released primarily to encourage interest in the IPO, or if it reasonably can be expected to encourage interest in the IPO, directly or indirectly. For this reason, projections and forecasts can be risky, as can advertising and press appearances, even if the offer of securities is not discussed. An offer can be made orally, in writing, or through any medium. For example, a company's communications to its employees over an internal intranet can be an offer.

Because these pre-filing restrictions are so broad, the SEC has created several corresponding safe harbors. Companies can rely on these safe harbors to ensure that certain ordinary communications do not violate the gun jumping rules. Four key safe harbor provisions are SEC Rules 163A, 169, 135, and 163B, which permit specific types of pre-filing communications. Under Rule 163A, a communication will not be considered an offer if it is made more than thirty days before a registration statement is filed and does not refer to a securities offering.[57] Under Rule 169, factual business information about the company is also not an offer if the company already releases that kind of information regularly, and for an intended use other than for investors or potential investors. Rule 135 permits certain notices of an upcoming offering before a registration statement is filed, but the notice can contain only very limited information and cannot name the underwriters. Most recently, and as discussed earlier, Rule 163B allows companies (not only EGCs) to "test the waters" by meeting with certain institutional investors before filing a registration statement.

Post-Filing (or Waiting) Period

When the company files its registration statement publicly, the quiet period ends, and the waiting period begins. During the waiting period, oral offers are permitted, but written offers are still restricted. A company may make written offers only by means of a prospectus that satisfies the requirements of the Securities Act or pursuant to one of the available safe harbors described above. SEC rules also require that an IPO prospectus include a price range when it is circulated to the market. As a result, aside from "testing the waters," companies typically refrain from speaking with investors until the preliminary prospectus—price range included—is filed.

Like in the pre-filing period, Rule 134 contains a safe harbor for a notice of offering with very limited information, including the names of underwriters.

After filing, a company may also generally make an offer by means of a "free writing prospectus," a written communication that does not comply with the statutory prospectus requirements. For an IPO, however, a free writing prospectus can be used only at the same time as or after the company has distributed a statutory prospectus with a price range. Given the lack of restrictions on the content of a free writing prospectus, though, it can help convey late-breaking information to the market during the offering process.

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[56] Securities Act § 2(a)(3).

[57] If an issuer uses the Rule 163A safe harbor, the issuer must also take "reasonable steps within its control" to ensure the relevant communication is not distributed further in the thirty days immediately preceding the filing. *See* Securities Act Rule 163A.

Post-Effectiveness Period

Once the registration statement has been declared effective—generally at the same time the IPO is priced—securities can be sold. For the next twenty-five days, dealers must deliver the final prospectus when making a sale, even if they were not underwriters in the IPO. If the prospectus is available on the SEC's EDGAR system, dealers can satisfy this requirement by providing a simple notice to purchasers. During this time, the company should not make statements that materially change the information in the prospectus. In practice, because of the prospectus delivery requirement, counsel often recommends that executives of the company do not give press interviews until this period ends. Nonetheless, it has become more common for CEOs to appear on financial television programs after the IPO is priced. Before doing so, the CEO should review all communications with company counsel.

Securities Liability and Due Diligence

The due diligence investigation is a major part of the IPO process. Under Section 11 of the Securities Act, an issuer is strictly liable for any material misstatements or omissions in the registration statement. The reasoning behind this requirement is that the company has the most information about itself and therefore should assume the most exposure.

As critical intermediaries between the issuer and the public, the company CEO, CFO, directors, other signatories on the registration statement, underwriters, and auditors are also subject to liability under Section 11. Unlike the company, these parties have a "due diligence" defense in a potential lawsuit. To benefit from the defense, the defendant must have performed a reasonable investigation, had reasonable grounds to believe, and in fact believed that the relevant disclosure was accurate and complete. For disclosures based on the authority of an expert such as an auditor, the other types of defendants can rely on those statements so long as they had no reason to believe the statements were inaccurate or incomplete. In practice, though, the working group will still complete extensive due diligence on the financial statements or any other "expertized" portions of the disclosure.

In an SEC-registered offering, Section 12(a)(2) of the Securities Act imposes liability on any person who offers or sells a security by means of offering material or oral communication that contains a material misstatement or omission. As in Section 11, a defendant may have a defense if it can show that it did not know of the misstatement or omission, and could not have known of it with reasonable care. In addition to the ability of private litigants to bring claims, the SEC can also bring enforcement actions for material misstatements or omissions.

If deal participants make any inaccurate or misleading statements, whether oral or written, they may also face liability under the federal securities laws' catch-all anti-fraud provisions: Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Recovery for a Rule 10b-5 claim is more challenging because a plaintiff must show that the defendant acted recklessly or willfully (scienter requirement) and that the plaintiff relied on the inaccurate or misleading statement.

In addition, Section 15 of the Securities Act and Section 20 of the Exchange Act can impose secondary liability on anyone who controls a party with primary liability. These provisions may apply unless the control person can show that it did not know, or had no reasonable grounds to know, of the facts that gave rise to the liability of the primarily liable party. "Control" includes any party that has the power to direct or cause the direction of the company's management and its policies, whether through ownership of voting securities, by contract, or otherwise. A private equity or venture capital sponsor, founder, or other significant shareholder therefore can have potential control person liability.

For all these reasons, due diligence is critical to the success of a transaction, as well as for protection from reputational and legal risk. Core elements of due diligence include the following:

— ***Management Due Diligence***. Senior management participates in a series of discussions, in which the CEO, CFO, and their main executives focus on the business. Separate, more specialized discussions with other members of management may cover topics such as tax, executive compensation, employee benefits, litigation, regulatory matters (including FCPA, sanctions, and anti-money laundering compliance), intellectual property, environmental matters, cybersecurity, data privacy, and any other significant areas. As discussed further below, the underwriters also obtain legal opinions and disclosure letters from company counsel and underwriters' counsel.

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

- ***Accounting Due Diligence***. Accounting due diligence centers on discussions with the auditor of the company's financial statements, the audit process, internal control over financial reporting, and other related matters. The underwriters also obtain comfort letters from the auditor.

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

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

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

Key Documentation

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

Prospectus and Registration Statement

The primary disclosure and offering document is the prospectus, a part of the registration statement filed with the SEC. After the company files its draft registration statement, the SEC staff in the Division of Corporation Finance reviews it and makes comments. The company updates its registration statement accordingly and addresses the SEC comments in a letter submitted on the EDGAR system alongside the updated registration statement. This back-and-forth continues until all comments are resolved to the satisfaction of the SEC, and the company files its final prospectus.

Three main sources determine the nature of disclosures in the registration statement. First, SEC rules and registration forms impose detailed disclosure requirements. In an IPO, these forms are Form S-1 for a U.S. issuer and Form F-1 for a foreign private issuer.[58] The forms refer to provisions of Regulations S-K and S-X (or Form 20-F for a foreign private issuer) that set forth the information and financial statements that must go in a registration statement. Required information ranges from detailed disclosure about the company's business to risk factors about the company and investments in its stock; the company's intended use of the proceeds from the offering; MD&A; disclosure of related-party and governance matters; disclosures about executives and their compensation; and disclosure of shareholders with stakes of 5% and greater.

Though they are not part of the prospectus and therefore not distributed to investors, specified exhibits must be filed with the registration statement. Interested investors can find these materials easily on EDGAR. Required exhibits are the company's organizational documents; the underwriting agreement; material agreements, such as indentures for bond offerings, credit facilities, and significant commercial contracts; compensation documents, including employment agreements with executive officers and equity compensation plans; and certain related-party contracts. Material agreements may contain commercially sensitive information that the company may not want its competitors, for example, to see. The material can be redacted if it is not material and its disclosure would be competitively harmful.[59]

Liability considerations are the second source of disclosures. Even if the disclosures satisfy the requirements of the SEC forms, they still must not be materially inaccurate or misleading. Measurements of materiality are both quantitative and qualitative. Misstatements that are inaccurate by only a small quantity, such as less than 5% of a relevant benchmark, may still be material from a qualitative perspective. No matter the magnitude, the error may be material if it gives a misleading impression of a key business or financial trend, changes a loss into a gain, portrays

58 This Overview and Guide does not address the forms under the U.S.-Canadian Multijurisdictional Disclosure System (MIDS).

59 In 2019, the SEC liberalized the rules on redacting competitively harmful information in this context, generally making it not necessary to submit a confidential treatment request to the SEC before redacting the information. *See* FAST Act Modernization and Simplification of Regulation S-K, Securities Act Release No. 33-10618 (Mar. 20, 2019). In November 2020, the SEC adjusted the exhibit filing requirements by removing the "competitively harm" standard and replacing it with a standard that permits information to be redacted from material contracts if it is the type of information that the issuer both customarily and actually treats as private and confidential, and which is also not material. *See* Facilitating Capital Formation and Expanding Opportunities by Improving Access to Capital in Private Markets, Securities Act Release No. 33-10844 (Nov. 2, 2020). These amendments bring the standard in line with the definition of "confidential" under Exemption 4 of the Freedom of Information Act (FOIA) established in the Supreme Court's decision in Food Marketing Institute v. Argus Leader Media, 139 S. Ct. 2356 (2019).

compliance with covenants or regulatory requirements inaccurately, or increases executive compensation.[60]

Marketing requirements and investor relations are the third source of disclosure. The prospectus tells the company's "story" to the market and helps position it among its peers. Specific practices in the company's industry or sector may suggest disclosing certain metrics or other information that analysts and investors like to see. The IPO disclosures become a template for the company's ongoing disclosures and the way it will communicate with the market as a public company. As the working group—company executives and external experts alike—concentrates on the prospectus, it should consider its approach carefully. The company will not want to commit to a format of disclosure that is unnecessarily burdensome or revealing. The group should choose an approach that makes sense not only for the IPO, but also for the long term.

Underwriting Agreement

The underwriting agreement is the contract in which the underwriters agree to purchase the offered securities from the company. Most major investment banks have form underwriting agreements that underwriters' counsel will use to start. Although the forms vary from firm to firm, the content is largely similar.

The centerpiece of the agreement is the number of securities to be sold and the price at which the underwriters will buy them. The underwriters typically require extensive representations and warranties from the company (and, to a lesser degree, from any selling shareholder) to support their due diligence, ensure adequate disclosure, and facilitate closing. These provisions also allocate risk between the company and the underwriters in the event that the underwriters are sued for a material misstatement or omission, and related representations and warranties are breached. In addition, the company, its insiders, and its significant shareholders usually commit to a "lock-up."

The agreement lists closing conditions, including receipt of legal opinions from issuers', underwriters', and, if applicable, selling shareholders' counsel; comfort letters from the auditor; and other certificates and closing documents. In addition, it specifies the circumstances in which the underwriters can terminate the offering, such as in the event of material adverse changes to the company or to market conditions. Underwriters rarely exercise their termination rights. In an IPO, the underwriters will not sign the underwriting agreement and commit to buy the securities until they have built a book of demand and are confident that they can sell the full amount of offered securities. For reputational reasons, underwriters also do not want to be known for walking away from transactions. Even during very disruptive market events, such as after September 11, 2001, market institutions kept functioning and transactions were completed with minimal delay.

The underwriting agreement also contains detailed indemnification and contribution provisions. These sections ensure that the company will make the underwriters whole if the underwriters suffer losses from being sued. These provisions are important in the context of funding ongoing defense to a claim. The underwriters may incur significant legal expenses before any final settlement or judgment is reached.

Because underwriters are usually full-service investment banks, they may have other commercial relationships with the company, like that of a commercial lender. When the proceeds from an offering will go to an underwriter, those relationships can pose conflicts. Underwriters are regulated by the Financial Industry Regulatory Authority (FINRA), which the SEC oversees. FINRA has detailed rules governing the disclosure of conflicts. In certain cases, FINRA rules require the involvement of an unconflicted underwriter (a "qualified independent underwriter," or QIU) in parts of the IPO process. FINRA rules also restrict excessive underwriting compensation. In practice, these rules are enforced by requiring underwriters to make filings with FINRA alongside the SEC filings. FINRA must issue a

[60] *See*, *e.g.*, SEC Staff Accounting Bulletin No. 99 (Aug. 13, 1999), known generally as "SAB 99."

notice of no objections before the SEC will declare an IPO registration statement effective.

Lock-Up Agreements

In an IPO, the underwriters almost always insist on a lock-up agreement from the company (which it includes in the underwriting agreement), as well as from directors, executive officers, and most, if not all, shareholders. Subject to limited exceptions and absent the lead underwriters' permission to do otherwise, these agreements restrict offers and sales of common stock, announcements of the intent to offer or sell common stock, or any transactions with the economic effect of an offer or sale typically for 180 days after pricing or another agreed length of time. The lock-up mitigates the risk of overhang by ensuring an orderly market for the stock following the IPO. It indicates to the market that there will be no significant dispositions of shares during that time. The lock-up also prevents insiders from selling their holdings right away. It shows that they support the offering, at least for the duration of the lock-up period, and will not use potentially temporary upswings in price to liquidate their holdings.

Road Show Presentation

Once most or all SEC comments have been cleared and the working group thinks market conditions are right, the IPO is "launched," and marketing begins. For one or two weeks, the company's top executives travel to meet prospective investors.[61] They present a slideshow with the essential elements of the offering and the investment case for the company. At the same time, the company puts online a recorded version of the road show slideshow, or a road show video. Counsel must ensure these materials are consistent with the disclosures in the prospectus, and that the presentation is materially accurate and complete. Though not subject to the same strict requirements as the registration statement, the road show materials carry liability risk under Rule 10b-5.

Auditor Comfort Letters

The underwriters require "comfort" letters from the auditor. In these letters, the auditor confirms its independence and certifies that it has audited the financial statements in the prospectus and reviewed the unaudited interim financial data in the prospectus. The auditor also provides comfort on financial data included in the "front half," or non-financial statement section of the prospectus, and confirms that data is consistent with the company's financial statements or records.[62] The comfort letter helps the underwriters confirm that the disclosure is correct and establish their due diligence defense. Although accounting literature specifies the contents and procedures for comfort letters, negotiating the comfort letter is often time-consuming. If no comfort is available for a particular piece of data, underwriters' counsel may need to take special care to verify its accuracy (and potentially request a CFO certificate with respect to such data).

Legal Opinions and Disclosure Letters

As a condition of closing, the underwriters also require a legal opinion and a negative assurance, or "10b-5," letter from company counsel and underwriters' counsel. Like the comfort letters, these documents identify anything that might jeopardize the transaction and help establish a due diligence defense.

In general, the legal opinions from company counsel and underwriters' counsel address the legal foundations of the offering. They confirm that the relevant agreements were properly made and that the securities are validly issued. They may address legal issues specific to the company or the transaction, such as certifying that

[61] Because of the coronavirus pandemic and related travel restrictions, virtual road shows have become a popular alternative to in-person meetings. This method is likely to remain popular in the future, as some companies have found virtual road shows more efficient and less expensive than traditional road shows, and that they facilitate reaching a broader investor base (or at least as part of a "hybrid" model combining both virtual and in-person meetings). *See* Nina Trentmann, *Companies Find a Lot to Like About Virtual IPOs*, WALL ST. J. (July 2, 2020).

[62] Financial data is different from statistical data. The former refers to numbers taken or derived from the company's financial statements or underlying financial information, while the latter relates to matters such as the number of stores a company has or similar business-related information not usually included in U.S. GAAP or IFRS financial statements or underlying records.

the company need not register under the Investment Company Act of 1940, as amended, or that the company is in compliance with specified regulatory requirements. If external deal counsel for the company cannot render an opinion, the company's in-house counsel, local counsel in specified jurisdictions, or specialized regulatory counsel can provide it instead.

The negative assurance, or 10b-5, letters confirm that the lawyers have not found anything that has come to their attention in their work that suggests the disclosure is materially inaccurate or misleading. The structure of the assurance in these letters incorporates the various liability standards in the securities laws, including sections 11 and 12(a)(2) of the Securities Act. Because legal opinions and negative assurance letters can be complex, underwriters' counsel may start negotiating drafts early in the offering process.

Timeline

The IPO process generally takes between six to nine months once the working group is assembled and the process begins.

Week	Event	Responsible Parties
Week 1	Organizational meeting.	All parties: company, lead manager(s), underwriters, company counsel, underwriters' counsel, and auditor.
Week 2	Begin first draft of registration statement.	Company and its counsel draft the registration statement; all parties review and comment on draft.
	Begin legal due diligence.	Underwriters' counsel and company counsel conduct legal due diligence.
Weeks 3–7	Draft registration statement.	Company and its counsel draft the registration statement; all parties review and comment on draft.
	Begin management and auditor due diligence.	Lead manager(s) along with counsel and counsel to company participate in due diligence sessions.
Week 8	Complete due diligence, finalize registration statement, and submit registration statement to SEC on EDGAR (confidentially, if desired).	All parties.
	Negotiate underwriting agreement.	Counsel to underwriters and company.
Weeks 8–11	Prepare road show.	Lead manager(s) with assistance from company.
Week 12	Receive SEC comments (usually takes four weeks for the first round).	
Week 13	Respond to SEC comments and submit amendment to registration statement.	Company and its counsel draft responses to SEC comments and amendment to registration statement; all parties review and comment on responses and draft.
Weeks 13–17	Clear additional SEC comments (will likely take several rounds of comments, which can lengthen process).	
Week 17	Print and circulate preliminary prospectus; begin road show.	Lead manager(s) prepare the company for the road show—rehearsals, travel/virtual meeting logistics, etc. Underwriters will accompany company for entire road show, whether virtual or in-person.
		An EGC that submitted a registration statement confidentially must make the offering document public at least 15 days before the road show commences.
Weeks 18–19	Continue road show.	

Week	Event	Responsible Parties
Week 20	Registration statement declared effective by SEC. Pricing ("T").	All parties.
	Execute underwriting agreement.	Underwriting agreement signed by company, underwriters and selling shareholders, if any.
	File on EDGAR and circulate final prospectus to those investors who request a copy.	
Weeks 20–21	Closing (T + 2 business days; 3 if price after 4:30 p.m. (EST)).[63]	All parties.

Pre-Filing: Drafting the Registration Statement and Due Diligence

In the first approximately eight weeks, the working group begins by drafting the registration statement. The group may meet for in-person (or virtual) drafting sessions several times. At the same time, ongoing due diligence helps refine the disclosure and identify any potential issues. Underwriters' counsel may also begin negotiating the underwriting agreement during this time, so it is close to final before the initial filing of the registration statement with the SEC.

Filing and the SEC Comment Process

Once the registration statement satisfies both the working group and the SEC's content requirements, the company files the registration statement with the SEC on EDGAR, either publicly or confidentially. Underwriters' counsel files the registration statement with FINRA at the same time. The SEC usually takes approximately thirty days to provide its initial written comments. During those thirty days, the working group turns to other documents, continues due diligence as needed, and begins the process for listing on a stock exchange. The lead underwriters and management also work on the road show presentation.

Once the company receives the first set of comments from the SEC, company counsel organizes the response, with input from the working group, including internal company accounting/finance teams and the outside auditor on the accounting comments. Responses may take one or two weeks to draft and compile, depending on the nature and number of comments received. This process often continues for several more rounds, though each subsequent round generally brings fewer comments and faster turnaround times. The entire comment process usually takes about two months. During that time, the working group may focus on other agreements, FINRA clearance, the selection of a securities exchange, and other tasks. The company management team practices and refines the road show presentation and prepares for question and answer sessions with investors.

Road Show: Rules of the Road

When the SEC comment process is almost or fully complete, the company's preliminary prospectus, or "red herring," is unlikely to need further revision (barring any subsequent material developments). At this point, the company and lead underwriters determine a price range for the offering, print the preliminary prospectus, and begin the road show. The lead underwriters organize this one- to two-week period of travel (or virtual meetings) and marketing for the company. Company management presents its road show slide deck to prospective investors, and the lead underwriters build the book of demand. Based on the demand they receive, the lead underwriters adjust the

[63] On February 15, 2023, the SEC adopted rules that will shorten the standard settlement cycle for most broker-dealer transactions from T+2 to T+1 (one business day after the trade date). The final rules became effective on May 5, 2023, but compliance with the T+1 standard settlement cycle will not be required until May 28, 2024. *See* Shortening the Securities Transaction Settlement Cycle, Final Rule, Exchange Act Release No. 34-96930 (Feb. 15, 2023).

price range and offering size if needed, and ultimately help the company set the price for the offering.

Effectiveness, Pricing, and Closing

Once the road show is complete and the company is ready to price its IPO, the company and the underwriters will request that the SEC declare the registration statement effective.[64] After the market closes on the day the registration statement is declared effective, the final share price is determined, the underwriting agreement is signed, and the auditor's comfort letter is delivered. The underwriters then begin oral confirmations of sales. If demand for the offering has changed substantially, its terms may change as well. Complex SEC rules limit last-minute changes in the price per share or number of shares to be sold. If demand is uncertain or market conditions especially volatile, the working group should consider its options under these rules well before pricing. A significant upsizing or downsizing of the offering can also be material. If so, the company must disclose the impact to investors, usually in a free writing prospectus.

When the pricing information is added to the preliminary prospectus, the prospectus becomes final. It is filed on EDGAR within forty-eight hours of pricing and made available to those who received allocations of shares in the offering.

After pricing, the shares begin trading on the securities exchange. A company usually "rings the bell" at its chosen exchange to open trading on the day after pricing. Trading occurs on a "when-issued" basis, before the actual issuance of the securities at closing, which normally happens two or three business days after pricing. Legal opinions, disclosure letters, bring-down comfort letters, and other documents are all delivered at closing, and the securities are issued against payment of the purchase price.

[64] FINRA clearance and securities exchange approval must also be secured at this point.

Life As a Public Company

Once public, a company will be subject to the ongoing reporting requirements of the Exchange Act and other obligations.[65]

Form 10-K/Form 20-F

A U.S. issuer must file an annual report on Form 10-K. The report contains much of the same information as the IPO registration statement. It gives a comprehensive overview of the company's business, including audited consolidated financial statements, risk factors, and MD&A. For its first year after the IPO, a company must file this report within ninety days of the fiscal year-end.[66] A foreign private issuer must file a similar annual report on Form 20-F within four months of the end of its fiscal year.

Form 10-Q

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

Form 8-K/Form 6-K

A U.S. issuer must file current reports on Form 8-K to disclose specified material events or corporate changes. The reports are generally due within four business days of the relevant event or change. These events include entry into a material definitive agreement, significant acquisitions or dispositions of assets, changes in directors or executive officers, and amendments to organizational documents and, as a result of recent Form 8-K amendments, material cybersecurity events. Companies also furnish a Form 8-K each quarter when they announce earnings.[67] Form 6-K is the analogue for a foreign private issuer and must be furnished to the SEC promptly after the issuer makes a material disclosure to its shareholders.

Proxy Regime

When a public company (other than a foreign private issuer) seeks shareholder proxies for a vote, it must file a proxy statement with the SEC (and in some cases, the relevant stock exchange) to allow the SEC to comment before the statement is distributed to investors. The proxy process requires planning to comply with notice requirements in the company's organizational documents and SEC rules, and to coordinate between the company's transfer agent, proxy solicitor, financial printer, and the SEC.

In the face of shareholder pressure, many companies have adopted "proxy access" procedures in their governance documents. "Proxy access" is the idea that shareholders satisfying specified ownership thresholds

[65] A company can become subject to Exchange Act reporting in several ways: (i) by doing an SEC-registered offering of securities; (ii) by listing securities on a U.S. national securities exchange; (iii) by having more than 2,000 record holders or more than 500 record holders that are not "accredited investors," excluding, among others, persons who received securities pursuant to employee compensation plans in transactions exempt from Securities Act registration; or (iv) voluntarily.

[66] After a company has been an SEC registrant for a year, if its market capitalization is $75 million or more, it becomes an accelerated filer, and if it is $700 million or more, a large accelerated filer, which will result in shorter deadlines for its Form 10-K and Form 10-Q in the case of a U.S. issuer (but not Form 20-F for a foreign private issuer).

[67] Whether a form must be filed with or furnished to the SEC changes the liability associated with it. Forms that are filed carry greater liability for materially misleading statements or material omissions than information that is furnished to the SEC. *See* Exchange Act § 18.

should be able to place director nominees directly in a company's proxy statement. The SEC has considered the issue of proxy access several times, including when it adopted Rule 14a-11 under the Exchange Act in 2010. In 2011, however, the U.S. Court of Appeals for the D.C. Circuit vacated that rule. In recent years, many companies have nevertheless adopted proxy access procedures in their governance documents. These procedures generally allow nomination of 20–25% of the board by qualifying shareholders and require that shareholders own 3% of the company for at least a three-year period, with no current intent to influence control of the company, in order to qualify.

Shareholders may also use the SEC's new "universal proxy" rules to nominate directors. Effective in September 2022, the universal proxy rules require that proxy cards list all director candidates for shareholder votes.[68] In the past, if an activist shareholder nominated directors, the activist would distribute a proxy card to shareholders that listed only its slate of director nominees. The company would distribute a proxy card with its slate of directors, and shareholders would vote for one slate or the other. Under the new rules, all proxy cards must be "universal" and include all director nominees. Rather than vote for an entire slate, shareholders may pick and choose individual directors when they cast their votes. Unlike for proxy access, a shareholder does not need to hold a minimum amount to nominate a director, and there is no minimum holding period. A nominating shareholder must, however, solicit votes from at least 67% of the company's shareholders and meet other requirements of the company's governance documents. To protect against activist investors in light of the new rules, many public companies have amended their governance documents to bolster requirements for advance notice, information that a nominating shareholder must provide, and other proxy mechanics.

Schedule 13D/G

The Schedule 13D/G regime is intended to inform the public of who controls significant voting power in a public company to prevent a clandestine takeover.[69] Beneficial owners of more than 5% of a class of Exchange Act-registered voting equity (such as most companies' publicly traded common stock) must report their ownership publicly on Schedule 13D. Certain passive and pre-IPO holders can complete Schedule 13G, a shorter form that requires less information. Beneficial ownership is determined broadly. It includes convertible securities or other rights of a holder to acquire underlying equity within sixty days, without taking into account the conversion or exercise of similar rights by any other holder.

When two or more beneficial holders agree to act together to acquire, hold, vote, or dispose of the equity securities of a company, they are considered to have formed a Section 13D group. They must file reports indicating as much, either jointly or individually. and acknowledging their group status. Private equity and venture capital sponsors who join other sponsors to acquire a company frequently report as groups after an IPO because they continue to own a large position in the company and control it though a shareholders' agreement or similar arrangement.

68 *See* Universal Proxy, Exchange Act Release No. 34-93596 (Nov. 17, 2022).

69 In October 2023, the SEC adopted substantial amendments to the Schedule 13D/G reporting regime, including with respect to certain filing deadlines, frequency of amendments and application to cash-settled derivatives, and also offered guidance on the scope of activities that could give rise to group formation and control intent. *See* Modernization of Beneficial Ownership Reporting, Final Rule, Exchange Act Release No. 34-98704 (Oct. 10, 2023).

Tender Offer Regime

Tender offers for Exchange Act-registered equity securities must comply with SEC tender offer rules.[70] These rules are designed to promote the fair treatment of all security holders. A tender offer is not defined, but rather identified by the active and widespread solicitation of holders; solicitation of a substantial portion of the outstanding class; offering at a premium over the prevailing market price; firm, rather than negotiable, terms; offering only for a limited time; conditioning the solicitation on a minimum number of shares or subjecting it to a fixed maximum; pressuring holders to sell; and making public announcements. A tender offer for registered equity requires a tender offer document to be filed with the SEC. If the tender takes the form of an exchange offer, it can also require the filing of a registration statement for the offered securities on Form S-4 for a U.S. issuer and Form F-4 for a foreign private issuer. SEC rules generally require that the offer remain open for at least twenty business days; that tendering holders have withdrawal rights during the offering period; that all holders receive the same offer; and that payment of the consideration be made promptly to tendering holders, in addition to other requirements. Both third parties and issuers tendering their own securities must comply with applicable tender offer rules.

Section 16

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

If an individual person owns less than 10% but belongs to a group that collectively owns more than 10%, that person is treated as an insider under Section 16. As a result, shareholders must monitor potential joint activity with other shareholders, such as in the context of activism.

Other Large Holder Considerations

Holders of public company securities should also be mindful of other compliance obligations. For example, institutional investment managers with discretion over $100 million or more in exchange-traded stocks and other securities must file Form 13F disclosing their positions each quarter. In 2020, the SEC proposed increasing this threshold to $3.5 billion, but did not adopt the change after widespread opposition from commenters.[71]

Similarly, "large traders"—persons trading exchange-listed equity and certain other securities of at least (i) two million shares or $20 million during any calendar day, or (ii) 20 million shares or $200 million during any calendar month—must register under Form 13H, file quarterly confidential reports with the SEC with information about their brokerage arrangements, and tag trades with a special identifier.

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

[71] Press Release, SEC Proposes Amendments to Update Form 13F for Institutional Investment Managers; Amend Reporting Threshold to Reflect Today's Equity Markets (July 10, 2020).

Among other things, the acquisition of a significant stake in a public company can trigger the target company's anti-takeover provisions; antitrust filing and clearance obligations; and notice, consent, or other compliance obligations in regulated industries like banking, energy, insurance, and gaming.

Earnings Reports

As noted earlier, the scrutiny associated with quarterly reporting is a marked feature of life as a public company. Each quarter, public companies publish earnings releases before or at the same time as they file their corresponding quarterly or annual reports. Along with the release, they hold an earnings call in which top executives discuss the business, financial results, and condition of the company. Research analysts then ask questions to help them prepare their reports. These reports, and in particular, analysts' price targets and recommendations to buy, hold, or sell a security, affect stock price and performance significantly. If a company does not meet the street's "consensus" estimate for a reporting period, for example, its stock price may go down. The analysts distill and convey financial information to their clients and, indirectly, to the market as a whole.

A public company must also determine if it will give earnings guidance. If so, it must decide whether to do so quarterly or annually, and in what level of detail: revenue only, or revenue, earnings, and possibly other metrics (including non-GAAP metrics; see section 1:17.10 below). Guidance can help research analysts come to a consensus. It may bring more transparency and therefore less volatility in the stock price. But giving guidance can also bring more emphasis on short-term performance and legal uncertainty around whether or when to update it. Although some federal appellate circuit courts have rejected a duty to update or held that a duty does not apply to routine earnings guidance, others have not yet addressed the question in this context. Many companies continue to give guidance, but some no longer do.

Non-GAAP Financial Measures

In many industries, research analysts rely on certain non-GAAP metrics to evaluate companies. Common examples of non-GAAP financial measures include EBITDA, EBIT, adjusted EBITDA, free cash flow, economic net income, and adjusted net income.[72] The SEC generally allows these metrics, but regulates their use through Regulation G and Regulation S-K Item 10(e). Most importantly, a non-GAAP financial measure must be reconciled to its closest U.S. GAAP analogue. The non-GAAP measure cannot be adjusted to eliminate or smooth over nonrecurring, infrequent, or unusual items when the charge or gain is reasonably likely to recur within two years, or where a similar charge or gain occurred in the preceding two years. In certain circumstances, the SEC rules require that the most comparable U.S. GAAP measure be given equal or greater prominence with the non-GAAP metric. As it prepares for its IPO, a company in a sector that uses non-GAAP measures should examine its peers' practices and SEC requirements to inform its own approach.

Regulation FD

Regulation FD, for "fair disclosure," prohibits a U.S. issuer from disclosing material non-public information selectively, to certain market professionals or security holders only. Foreign private issuers often follow Regulation FD if their home country has a similar regulation, or as a best practice to avoid potential insider trading liability. The restrictions do not apply in the context of selective disclosures to those who owe duties of trust or confidence to the issuer, such as lawyers, investment bankers, and accountants. The restrictions

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[72] Since 2020, U.S. public companies have also faced questions about how to adjust certain non-GAAP financial measures to account for the impact of the coronavirus pandemic on their businesses. The SEC has repeatedly emphasized the importance of including timely and up-to-date disclosure on the impact of COVID-19 on the business, financial condition, and results of operations of companies, even where the ultimate impact of the pandemic and related effects on the company may be uncertain. *See, e.g.*, CF Disclosure Guidance Topic No. 9; CF Disclosure Guidance: Topic No. 9A; Sagar Teotia, SEC Chief Accountant, Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 (June 23, 2020).

also do not cover disclosures to those who expressly agree to maintain the information in confidence.

If a company discloses material non-public information selectively and intentionally, it must disclose the information publicly at the same time. If a company discloses material non-public information selectively and inadvertently, it must make a prompt public disclosure, usually within twenty-four hours. Most issuers satisfy the public disclosure requirement by furnishing a Form 8-K and publishing a press release. Corporate websites and social media channels can also be sufficiently public for Regulation FD, but only if the company had previously indicated its plans to use them to share material information with the public.

Sarbanes-Oxley Act

Various additional compliance considerations apply to public companies, some with phase-in periods and some without. Many are the results of the Sarbanes-Oxley Act of 2002. These include: a prohibition on extensions of credit to the company's directors and executive officers; personal certifications by the company's CEO and CFO of annual and quarterly reports regarding the absence of material misstatements or omissions, compliance of financial statements with Exchange Act requirements, and other matters; implementation and maintenance of disclosure controls and procedures; implementation and maintenance of internal control over financial reporting; and the preparation of a management report on internal control over financial reporting and a related attestation report by the company's auditor. In addition, the Sarbanes-Oxley Act requires the SEC to review public companies at least once every three years. This review may result in an SEC comment letter to the company.

Dodd-Frank Act

In October 2022, the SEC adopted new rules to implement the incentive-based compensation recovery, or clawback, provisions of the Dodd-Frank Act of 2010 (the "Dodd-Frank Act").[73] Under the rules, securities exchanges must require listed companies to adopt "no fault" compensation recovery policies that meet strict recovery standards, disclose any recoveries made under these policies, and file the policies publicly. If the issuer must restate any of its financial statements because of material noncompliance with the SEC's financial reporting requirements, then the issuer must recover any incentive compensation, whether in cash or equity, paid to any current or former executive officer in any of the three preceding fiscal years. The rules apply to both "Big R" and "little r" financial restatements.[74] Even if an executive officer is no longer serving in that capacity when the clawback is required, he or she may be subject to a clawback; however, if the person did not serve as an executive officer during any of the three preceding years, the clawback does not apply to the person. The definition of "executive officer" in the rules matches the definition of this term in section 16.[75] Issuers were required to adopt these recovery policies no later than December 1, 2023.[76]

[73] *See* Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 33-11126 (Oct. 26, 2022).

[74] "Big R" restatements correct errors that are material to previously issued financial statements. "Little r" restatements correct errors that are not material to the previously issued financial statement, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period.

[75] The definition states that "an executive officer is the issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division, or function (such as sales, administration, or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Executive officers of the issuer's parent(s) or subsidiaries are deemed executive officers of the issuer if they perform such policy making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers, or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust. Policy-making function is not intended to include policy-making functions that are not significant."

[76] On June 9, 2023, the SEC approved the proposed clawback listing standards of the NYSE and NASDAQ, including the amendments that delay the effective date of the rules to October 2, 2023 (such that NYSE- and NASDAQ-listed issuers were required to adopt compliant clawback policies no later than December 1, 2023). *See* Exchange Act Release Nos. 34-97687 (June 9, 2023) and 34-97688 (June 9, 2023).

Conflict Minerals

Both U.S. and foreign private issuers are subject to the SEC's conflict mineral rules, which it adopted under the Dodd-Frank Act. Issuers must file an annual report on Form SD with the company's use of specified minerals from the Democratic Republic of the Congo and neighboring countries, to the extent the minerals are "necessary to the functionality or production of a product" of the company. Given the widespread use of these minerals in products like jewelry, electronics, lighting, and electrical and heating applications, these rules apply to many companies. The compliance burden can be significant on companies and their suppliers, from which the company needs information to prepare its report. In addition, after a phase-in period (which is currently suspended by the SEC), an affected company must obtain an independent private sector audit of its report. Although the D.C. Circuit Court of Appeals held that certain statements required by the conflict mineral rules are unconstitutional, much of the work required for the conflict minerals disclosures is still required.

Iran Notice

If a public company or any of its affiliates knowingly engages in specified transactions, including dealings with the Government of Iran or other designated Iranian entities, it must report those activities in its annual and quarterly reports, and concurrently file an IRANNOTICE with the SEC. This requirement applies to both U.S. and foreign private issuers and does not contain a de minimis exception. Following U.S. withdrawal from the Iran nuclear deal in 2018, much of the disclosure has related to activities of foreign subsidiaries, with the disclosure often noting past activities that the company is winding down.

XBRL

A U.S. company and any foreign private issuer that prepares its financial statements in accordance with U.S. GAAP must provide financial statements to the SEC in interactive data (XBRL) format. This format makes the financial statements machine-readable so they can be downloaded, analyzed, and compared.[77]

[77] A foreign private issuer that prepares its financial statements in accordance with IFRS must also comply with XBRL requirements and use the taxonomy provided by the SEC. *See* IFRS Taxonomy (Mar. 1, 2017).

Company and Selling Security Holder Financing Options Post-IPO

After its IPO, a company has easy access to the public markets and can make offers quickly when market conditions are good. The main way to do so is through shelf registration. In a shelf registration, a company registers equity and debt securities on behalf of itself and/or selling security holders that it may later sell (or "take off the shelf") without another need for SEC review. The shelf establishes the broad framework for future offerings and incorporates the company's retrospective and forward-looking Exchange Act disclosures. A prospectus supplement describes the terms of a particular offering off the shelf. Together, the base disclosure and supplement form a complete "prospectus" for the offering.

A company generally cannot use a shelf until it has been a reporting company for twelve months and filed its periodic Exchange Act reports on time. The company files the shelf with the SEC, the SEC reviews and declares the shelf effective, and then the company can generally use it for three years. If the issuer qualifies as a "well-known seasoned issuer" (WKSI)—if its market capitalization exceeds $700 million or, for a debt shelf, if it has issued at least $1 billion in debt in the prior three years, among other requirements—its shelf becomes effective automatically on filing (and therefore no prior SEC review), enabling even faster access to the market.

Even after the IPO lock-up ends, a founder or sponsor with a significant ownership stake or a board position may be unable to resell its securities freely. Because these parties are affiliates of the issuer, their securities are treated as "control securities," which are subject to restrictions on free public resale. An affiliate of the issuer is a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the company. "Control" is the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. The existence of a control relationship depends on the facts and circumstances of each case. Common indicators of control include ownership of more than 10% of a company's outstanding voting securities, a board seat, an executive officer title, or special voting rights, such as a veto.

Under the securities laws, these securities cannot be resold freely if they are acquired directly or indirectly from a company or affiliate in a transaction or chain of transactions that does not involve a public offering. Instead, for these "restricted securities," the holder of the securities must keep them for six months (in the case of Exchange Act-reporting companies that are not delinquent in filing certain reports) or one year (in other cases) before free public resale is permitted. In an IPO, however, pre-IPO investors have often held their securities for much longer. Even if they have not, they generally cannot sell before the end of the 180-day lock-up period.

Under Rule 144 of the Securities Act, control securities (that are not restricted or, if restricted, for which the holding period has elapsed) can be freely resold publicly, but only if they are "dribbled out" to the market in unsolicited, volume-constrained sales that mimic secondary market trading. Private resales of control securities to sophisticated purchasers are also possible. Because those transactions may leave the buyer with restricted securities, the buyer may request a discount because of the illiquidity of the acquired shares.

Because of these constraints, sponsors and founders may negotiate for registration rights at the time of IPO. Registration rights allow the holders to cause the company to register their securities to facilitate their free public resale. The company will generally commit to support a certain number of offerings by the selling security holder, including in underwritten transactions. These rights help ensure liquidity for selling security holders.

In addition to selling on a registered basis or under an available exemption, selling security holders must not sell or buy securities while they have material non-public information. Doing so may result in insider trading liability and enforcement. To help prevent insider trading violations and the appearance of any impropriety, most public companies have window or blackout policies. These policies allow trading only during specified periods and "black it out" at all other times. Trading is permitted only following a "cleansing" disclosure event, such as the publication of an earnings release. The window opens two or three days after the disclosure and closes again once the company has insight into its financial results for the current period. These cut-offs vary among industries and issuers, depending on the nature of their business and financial information.

If an insider wants to preserve the ability to sell when it may have material non-public information, it can enter into a "10b5-1 plan," pursuant to Rule 10b5-1 under the Exchange Act. If an insider is alleged to have traded on the basis of material non-public information, that insider's use of a qualifying 10b5-1 plan affords the insider an affirmative defense. Under a 10b5-1 plan, at a time when an insider does not possess material non-public information, the insider can delegate trading authority to another person or adopt a written trading plan. The insider surrenders the ability to influence the resulting trading decisions. When arranging these plans, insiders must always be mindful of Section 16 and avoid short-swing trading, absent an available exemption.

In December 2022, the SEC adopted significant amendments to Rule 10b5-1.[78] Under the new rule, after a person adopts a 10b5-1 plan, a certain amount of time must pass before any trading may occur under the plan. For directors and officers of a company, this "cooling-off" period is the later of ninety days after the plan is adopted and two days after the company discloses its financial results for the period in which the plan was adopted. For all other persons, the period is thirty days. A person generally may not have more than one 10b5-1 plan in place at any given time and, for plans that cover only a single trade, the affirmative defense is available only for one single-trade plan during any consecutive twelve-month period. In their section 16 filings, insiders must identify transactions made pursuant to a 10b5-1 plan, and anyone who enters into a 10b5-1 plan must "act in good faith" with respect to the plan.

The amendments also create new disclosure requirements for issuers. In regular quarterly filings, domestic issuers must disclose whether any director or officer has adopted or terminated a 10b5-1 plan. They must also disclose the material terms of those plans, including the name and title of the director or officer, the date of adoption or termination of the plan, the duration of the arrangement under the plan, and the aggregate number of securities to be bought or sold under the plan. In their annual filings on Form 10-K (or Form 20-F for foreign private issuers), issuers must disclose whether they have adopted an insider trading policy and (beginning with the first annual filing that covers the first full fiscal period that begins on or after October 1, 2023) file a copy of the policy as an exhibit.

[78] *See* Insider Trading Arrangements and Related Disclosures, Final Rule, Exchange Act Release No. 33-11138 (Dec. 14, 2022).

Conclusion

An IPO is a unique moment in the life of a company. This Overview and Guide is a high-level summary of some of the main considerations in that process. As with any complicated financial and legal undertaking, the devil is in the details. Going public can bring tremendous benefits. The familiarity of the business team and the support of experienced, savvy advisors (including counsel) are all critical to that success. Proper structuring, efficient management, and careful compliance are essential not only to the IPO process, but to life as a public company in the future.

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