

2017 IPO Report

CORPORATE



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REVIEW

The IPO market produced 98 IPOs in 2016, the second down year in row, coming in 36% below the tally of 152 IPOs in 2015. In the 12-year period preceding 2015, there were only three years in which IPO totals failed to reach the 100-IPO threshold.

The year started slowly, with the first quarter producing only eight IPOs, but the pace of new offerings subsequently improved and steadied, with the succeeding three quarters producing 30, 31 and 29 IPOs, respectively. The quarterly average of 31 IPOs that has prevailed over the past two years is less than two-thirds the quarterly average of 53 IPOs produced during 2013 and 2014.

Gross proceeds in 2016 were \$18.54 billion, 66% below the \$25.17 billion raised in 2015 and the lowest annual tally since the \$15.05 billion raised in 2003. Average annual gross proceeds for the 12-year period preceding 2016 were \$35.73 billion—93% higher than the corresponding figure for 2016.

IPOs by emerging growth companies (EGCs) accounted for 84% of the year's IPOs, down from 93% in 2015. Since the enactment of the JOBS Act in 2012, 85% of all IPOs have been by EGCs.

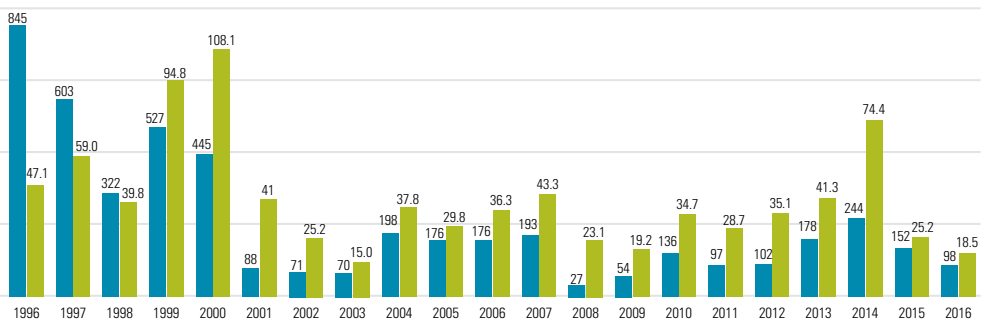
The median offering size for all 2016 IPOs was \$94.5 million, or 3% above the \$91.7 million figure for all 2015 IPOs, but 6% lower than the \$101.0 million median for the five-year period preceding 2015.

The median offering size for life sciences IPOs in 2016 was \$55.5 million, or 23% below the \$71.8 million figure for life sciences IPOs in 2015 and 11% below the \$62.4 million median size for life sciences IPOs in the five-year period preceding 2015. By contrast, the median offering size for non-life sciences IPOs in 2016 was \$131.6 million—up 2% from the \$128.5 million median in 2015 and up 3% from the \$128.1 million median for the five-year period preceding 2015.

In 2016, the median offering size for IPOs by EGCs was \$77.5 million, compared to \$368.6 million for IPOs by non-EGCs—both tallies representing the lowest annual levels since 2012. From 2012 to 2015, the median EGC IPO offering size was \$87.0 million, compared to \$425.5 million for non-EGC IPOs.

US IPOs by Year – 1996 to 2016

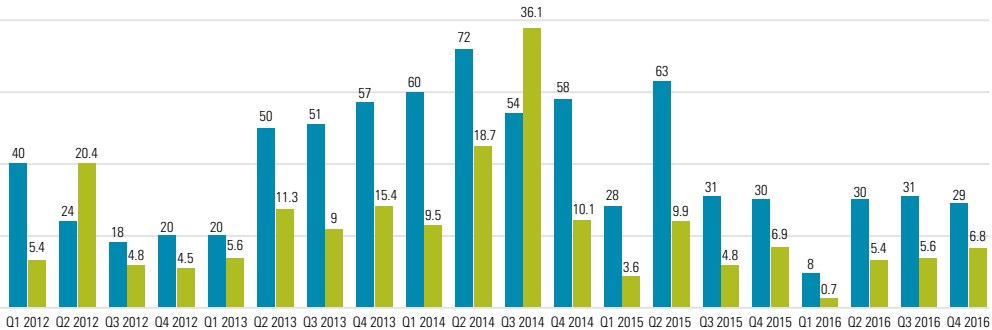
of IPOs Dollar volume (in \$ billions)



Source: SEC filings

US IPOs by Quarter – 2012 to 2016

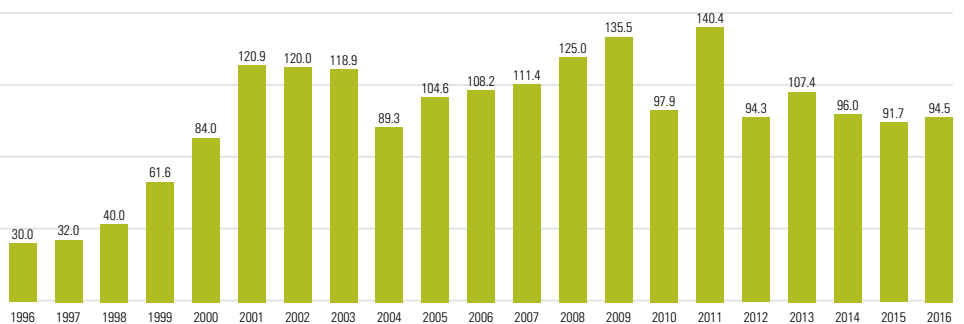
of IPOs Dollar volume (in \$ billions)



Source: SEC filings

Median IPO Offering Size – 1996 to 2016

\$ millions



Source: SEC filings

The median annual revenue of all IPO companies in 2016 was \$66.5 million, or 76% above the \$37.8 million median figure for 2015, but well below the \$92.7 million median figure for the five-year period from 2010 through 2014. The median life sciences IPO company in 2016 had annual revenue of \$2.3 million, compared to \$205.8 million for all other IPO companies.

EGC IPO companies in 2016 had median annual revenue of \$39.2 million, compared to \$1.54 billion for non-EGC IPO companies. The median annual revenue for non-life sciences EGC IPO companies in 2016 was \$113.8 million, 5% above the \$108.2 median that prevailed from the enactment of the JOBS Act through 2015.

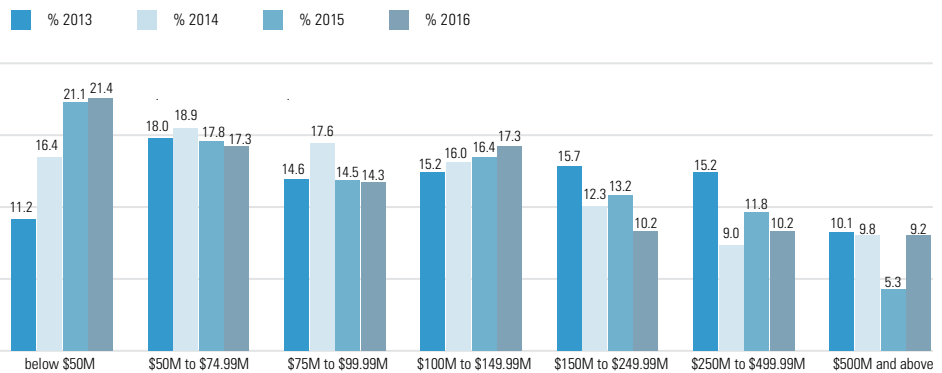
The percentage of profitable IPO companies increased to 36% in 2016 from 30% in 2015. Only four life sciences IPO companies in 2016, or 10% of the total, were profitable, matching the percentage over the five-year period preceding 2016. In 2016, 53% of non-life sciences IPO companies were profitable, down slightly from 55% for the five-year period preceding 2016.

In 2016, the average IPO produced a first-day gain of 12%, compared to 16% for the average IPO in 2015. The 2016 figure is the lowest since 2010. The average life sciences IPO company gained 6% in first-day trading in 2016, compared to 16% for the year's non-life sciences IPO companies. This represents a reversal from 2015, when the average life sciences company rose 18% on its first trading day—3% higher than the gain achieved by non-life sciences IPO companies. There was a solitary “moonshot” (an IPO that doubles in price on its opening day) in 2016—down from an annual average of six moonshots between 2013 and 2015.

In 2016, 24% of IPOs were “broken” (IPOs whose stock closes below the offering price on their first day). This figure is down from 26% in 2015. Life sciences company IPOs were twice as likely as other IPOs to be broken in 2016, with 35% of life sciences company IPOs closing first-day trading at a loss, compared to 17% of non-life sciences company IPOs.

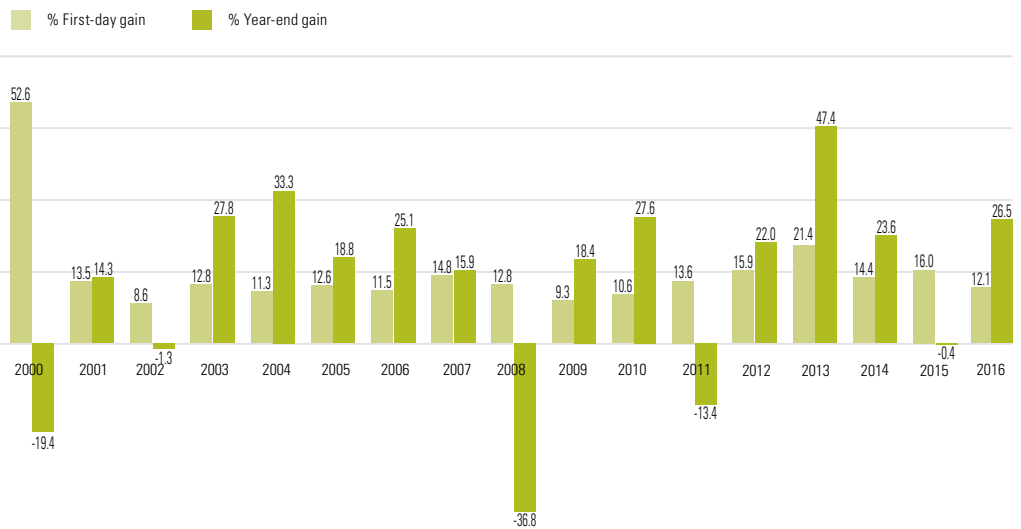
At year-end, the average 2016 life sciences IPO company was trading 16% above its offering price and the average non-life sciences IPO company was trading 34% above its offering price. Overall, the average

Distribution of IPO Offering Size – 2013 to 2016

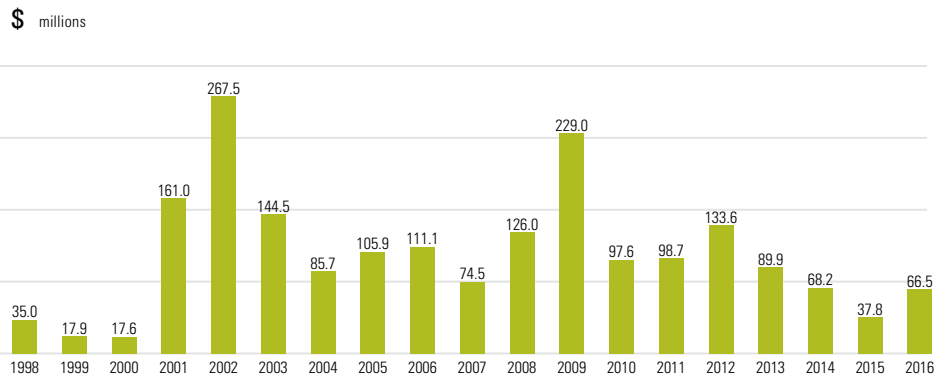


Source: SEC filings

Average IPO First-Day and Year-End Gain by Year – 2000 to 2016



Median Annual Revenue of IPO Companies – 1998 to 2016



Source: SEC filings and IPO Vital Signs

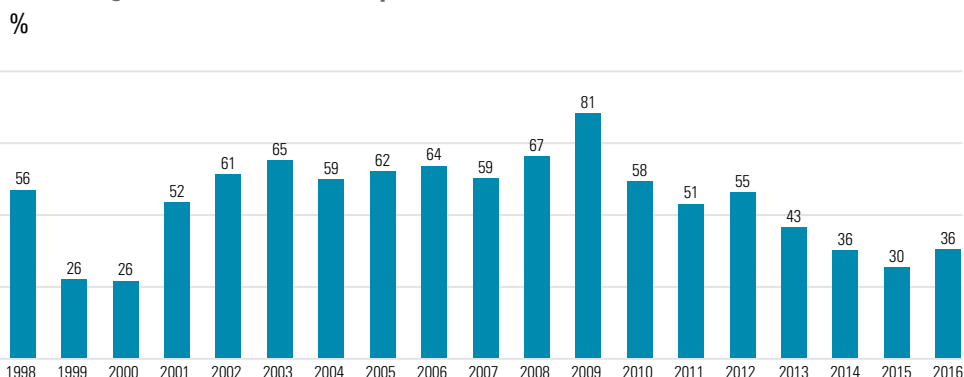
2016 IPO company ended the year 26% above its offering price. The year's best performers were a pair of tech companies, Acacia Communications (trading 168% above its offering price at year-end) and Impinj (up 152%), followed by life sciences companies Novan (up 146%) and AveXis (up 139%).

At the end of 2016, 30% of the year's IPO companies were trading below their offering price—life sciences companies faring worse than their non-life sciences counterparts, with a figure of 45%, compared to 19% for non-life sciences IPO companies—while 44% of all 2016 IPOs were trading at least 25% above their offering price.

Individual components of the IPO market fared as follows in 2016:

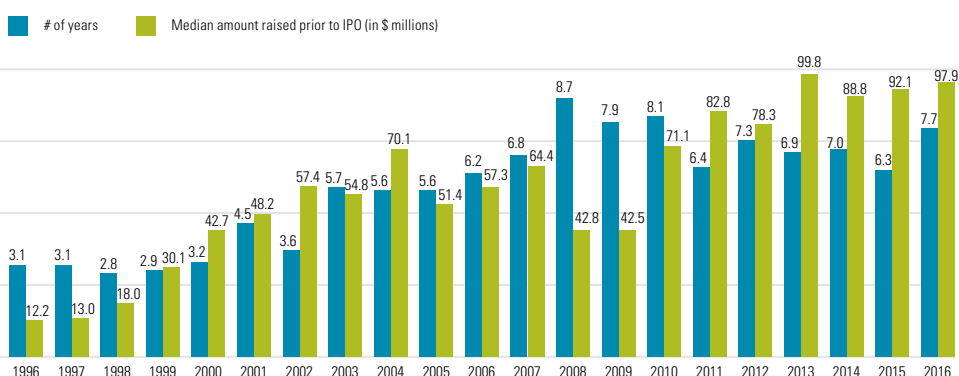
- VC-Backed IPOs:** The number of IPOs by venture capital-backed US issuers declined 38%, from 63 in 2015 to 39 in 2016, but VC-backed IPOs still accounted for 50% of all US-issuer IPOs in 2016. The median offering size for US venture-backed IPOs declined 4%, from \$77.9 million in 2015 to \$75.0 million in 2016. The median deal size for non-VC-backed companies was \$147.0 million in 2016, up 30% from \$113.3 million in 2015. The average 2016 US-issuer VC-backed IPO gained 30% from its offering price through year-end. The median amount of time from initial funding to an IPO increased from 6.3 years in 2015 to 7.7 years in 2016—the highest annual level since 2010—while the median amount raised prior to an IPO, at \$97.9 million, was the second-highest figure since 1996.
- PE-Backed IPOs:** Private equity-backed IPOs by US issuers declined by one-third, from 27 in 2015 to 18 in 2016, accounting for 23% of all US-issuer IPOs in each year. The median deal size for PE-backed IPOs in 2015 was \$250.0 million—more than triple the \$75.0 million figure for all other IPOs. The average PE-backed IPO in 2015 gained 34% from its offering price through year-end.
- Life Sciences IPOs:** There were 40 life sciences company IPOs in 2016, compared to 72 in 2015 and 98 in 2014. Although the portion of the IPO market accounted for by life sciences companies declined to 41% from 47% in 2015, this market share compares favorably to the 40% figure in

Percentage of Profitable IPO Companies – 1998 to 2016



Source: SEC filings and IPO Vital Signs

Median Time to IPO and Median Amount Raised Prior to IPO – 1996 to 2016



Source: Dow Jones VentureSource and SEC filings

2014 and is well above the 17% figure for the five-year period preceding 2014. The average life sciences IPO company in 2016 ended the year up 16% from its offering price, compared to a 34% year-end gain for non-life sciences IPO companies.

- Tech IPOs:** Deal flow in the technology sector declined by 29%, from 35 IPOs in 2015 to 25 IPOs in 2016—the lowest annual number since 2009—but the sector's share of the US IPO market increased from 23% to 26%. The 2015 figure was a low point for the sector, reached after five consecutive years of decline from the 46% US market share achieved in 2011. The average tech IPO ended the year with a gain of 37% from its offering price, compared to 23% for non-tech IPOs.

- Foreign-Issuer IPOs:** The number of US IPOs by foreign issuers declined by 43%, from 35 in 2015 (23% of the market) to 20 in 2016 (20% of the market). Among foreign issuers, Chinese companies led the year with six IPOs, followed by Bermuda companies (three IPOs) and companies from Switzerland and the Netherlands (each with a pair of IPOs). The average foreign issuer IPO company ended the year trading 12% above its offering price.

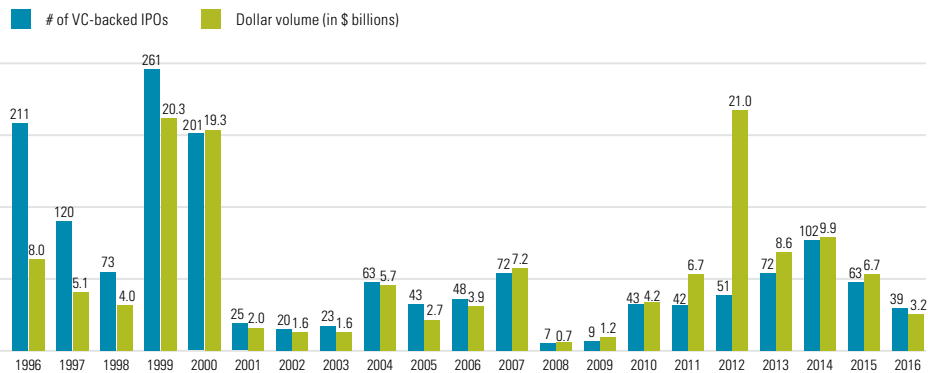
In 2016, 40 companies based in the eastern United States (east of the Mississippi River) completed IPOs, compared to 38 for western US-based issuers. California led the state rankings with 19 IPOs, followed by Massachusetts (with 12 IPOs), Texas (with six IPOs) and Georgia and Illinois (each with five IPOs).

OUTLOOK

IPO market activity in the coming year will depend on a number of factors, including the following:

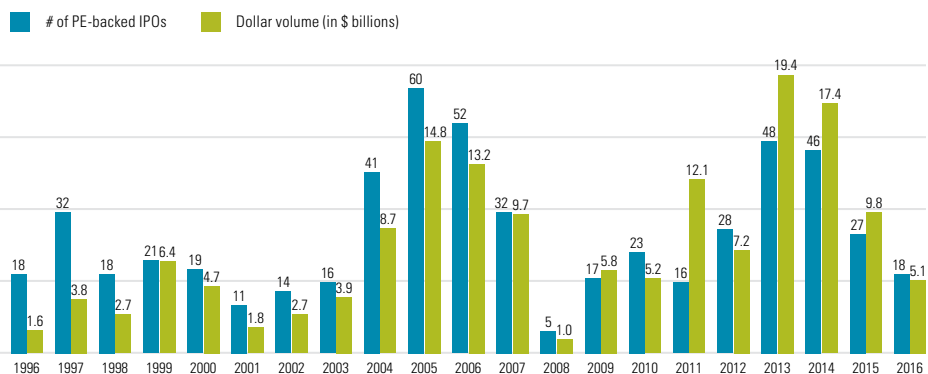
- Economic Growth:** The US economy lost momentum over the last three months of 2016 and the year ended with an annual growth rate of 1.6%—its weakest performance in five years. After raising its benchmark interest rate only once in the preceding decade, the Federal Reserve increased the rate in December 2016 and again in March 2017, and further rate hikes are widely expected in the coming year. These factors—together with uncertainty regarding the specific terms and timing of the Trump Administration’s tax and economic programs, the bumpy slowdown in China’s economic growth, the unknown outcome of Brexit, and political uncertainty in the Eurozone—all contribute to a hazy economic outlook in early 2017.
- Capital Market Conditions:** Following mixed results in 2015, the major US stock indices posted solid gains in 2016, with the Dow Jones Industrial Average up 14% and the S&P 500 and Nasdaq Composite Index each up 9%. Seemingly enthused by the pro-business orientation of the new administration, the major indices rose further, to record levels, in the first quarter of 2017, although the capital markets could begin to cool if economic growth weakens. Sustained strength in capital market conditions would likely contribute to increased IPO activity but, by itself, may be insufficient to restore IPO deal flow to the levels seen from 2013 to 2015.
- Venture Capital Pipeline:** Despite the decline in US venture-backed IPOs for the second consecutive year, the pool of VC-backed IPO candidates remains large and vibrant, including approximately 150 “unicorns” (private tech companies valued at \$1 billion or more). While access to plentiful private financing at attractive valuations tends to encourage VC-backed companies to delay their IPOs, investors at some point will seek cash returns as opposed to paper gains. The solid aftermarket performance of VC-backed IPOs in 2016 is likely to generate demand for additional IPOs in 2017.

Venture Capital–Backed IPOs – 1996 to 2016



Source: Dow Jones VentureSource and SEC filings
Based on US IPOs by VC-backed US issuers.

Private Equity–Backed IPOs – 1996 to 2016



Source: Thomson Reuters and SEC filings
Based on US IPOs by PE-backed US issuers.

- Private Equity Impact:** Having increased their fundraising for the fourth consecutive year, private equity firms are now sitting on record levels of committed capital. PE firms are eager to put their reserves to work, but the supply of capital is intensifying competition for quality deals and driving up prices. Despite increases in the level of equity invested in deals, which decreases investor returns, PE firms are facing pressure to exit investments—via IPOs or sales of portfolio companies—and return capital to investors.
- Impact of JOBS Act:** Although it was intended to encourage EGCs to go public, the JOBS Act—combined with other regulatory and market changes—has made it easier for EGCs to stay private longer and has provided them with

greater flexibility in timing their IPOs. The result has been a large and growing pool of qualified IPO candidates. The extent to which these companies decide to pursue IPOs, and the timing of these decisions, will have a substantial effect on the overall IPO market.

The IPO market has begun 2017 on a hopeful note, with 20 IPOs in the first quarter of the year—more than double the tally in the first quarter of 2016. In January, the impending AppDynamics IPO was poised to test investor appetite for IPOs by tech unicorns, until Cisco agreed at the last minute to acquire the company for \$3.7 billion in cash. Snap’s very successful IPO in early March could jump-start the market and inspire other qualified companies to follow suit. ■

6 Regional Market Review and Outlook

CALIFORNIA

The California IPO market produced 19 IPOs in 2016, a decline of 46% from the 35 in 2015 and the lowest annual number since 2009. Gross proceeds in 2016 were \$1.67 billion, down 64% from \$4.7 billion in 2015.

The results in 2016 represented the second consecutive year in which the California IPO market has contracted, after five successive years of growth.

The largest California IPO in 2016 came from Nutanix (\$238 million), followed by offerings from Twilio (\$150 million) and BlackLine (\$146 million).

The California IPO market continues to be dominated by technology and life sciences companies, which together accounted for all but one of the state's offerings in 2016, or 95% of the total, compared to an average of 56% for the rest of the country.

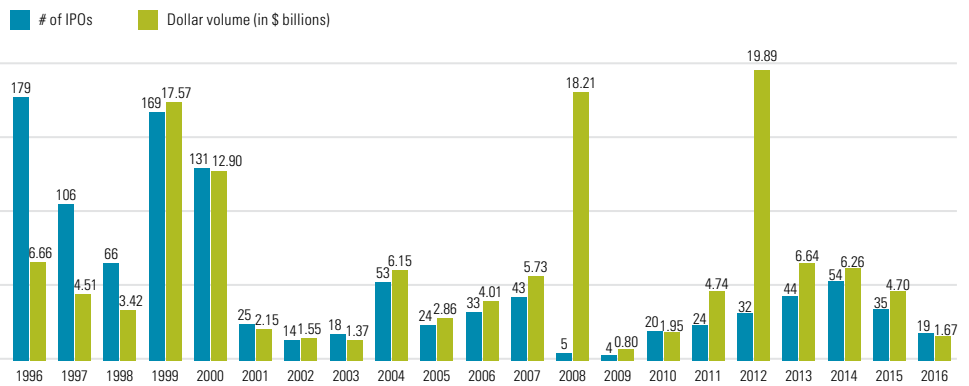
The number of venture-backed California IPOs decreased by 60%, from 30 in 2015 to 12 in 2016—representing 31% of all US-issuer VC-backed IPOs. By comparison, the state accounted for 47% of all US-issuer VC-backed IPOs over the five-year period preceding 2016.

At year-end, 79% of the state's IPOs were trading above their offering price, with the average California IPO up 38% from its offering price. The four best-performing California IPOs were all from venture capital-backed companies, led by Twilio (up 92% at year-end), Protagonist Therapeutics (up 83%) and Airgain (up 80%).

The average 2016 California IPO produced a first-day gain of 31%. The state's top performers were Nutanix (up 131% in first-day trading and the nation's only "moonshot" in 2016), Twilio (up 92%, essentially accounting for its entire gain for the year) and Coupa Software (up 85%).

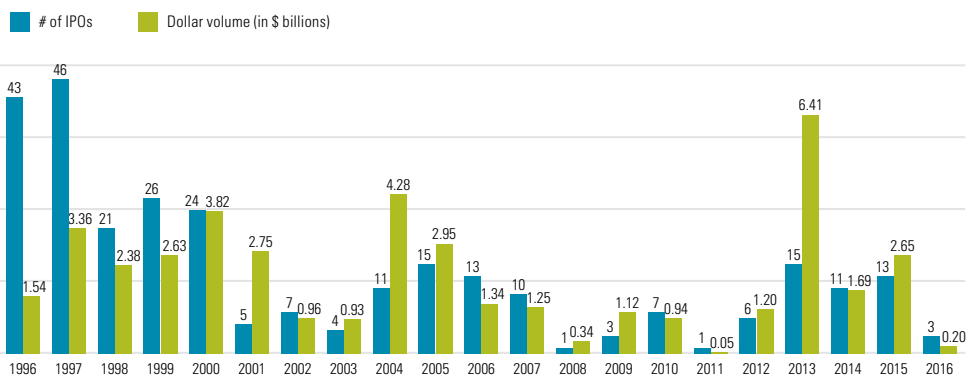
With the largest pool of venture capital-backed companies in the United States and a wealth of entrepreneurial talent, California should remain a major source of attractive IPO candidates in 2017, particularly from the technology and life sciences sectors.

California IPOs – 1996 to 2016



Source: SEC filings

Mid-Atlantic IPOs – 1996 to 2016



Source: SEC filings

MID-ATLANTIC

The mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia produced a trio of IPOs in 2016, a disappointing tally following three years with an IPO count in the double digits.

The region's three IPOs in 2016 represented the third-lowest annual figure in at least 20 years, topping only 2008 and 2011, which each saw only a single IPO.

The largest mid-Atlantic IPO of 2016 came from Virginia-based Kinsale Capital Group (\$106 million), followed by IPOs from two life sciences companies, North Carolina-based Novan and Maryland-based Senseonics (\$45 million each). The region's total proceeds in 2016 were \$196 million.

Novan and Kinsale Capital Group, the country's third and fifth best-performing IPOs of the year, were trading up 146% and 113%, respectively, at year-end, while Senseonics ended the year down 6% from its offering price. The region's best first-day performance (and fifth best in the country) came from Novan, up 65% on its opening day.

In a year with low deal flow, the pair of mid-Atlantic life sciences IPOs demonstrated the sector's continuing strength in the region, and the specialty insurance company IPO exemplified the region's diversity of industries. Given steady capital market conditions, the region is likely to see a rebound in IPO activity in the coming year, with offerings from the life sciences, technology and financial services sectors.

NEW ENGLAND

The number of New England IPOs dipped by one-quarter, from 16 in 2015 to 12 in 2016. Despite the decline, 2016 represents the fourth consecutive year that the region has produced a double-digit IPO count.

Massachusetts accounted for all twelve New England IPOs in 2016. The state's tally was the second-highest state total in the country for the fourth consecutive year, trailing only California.

Gross proceeds in the region declined 46%, to \$1.22 billion in 2016 from \$2.25 billion in 2015.

The largest New England IPO in 2016 was by Acushnet (\$329 million), followed by American Renal Associates (\$165 million) and Intellia Therapeutics (\$108 million).

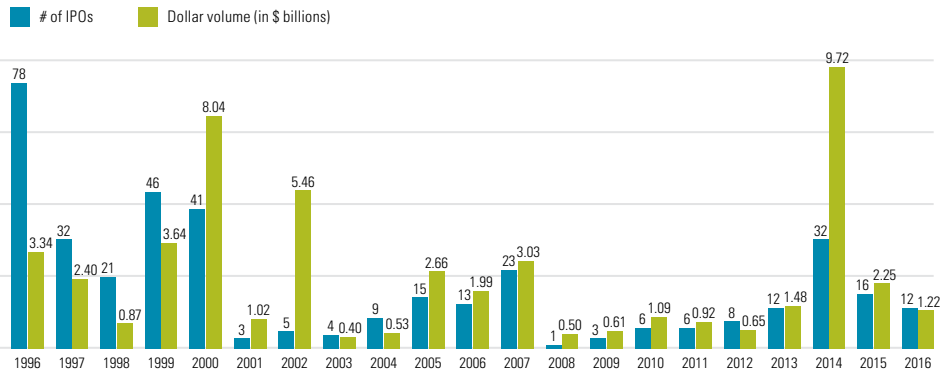
Life sciences companies accounted for two-thirds of the region's IPOs in 2016, representing one-fourth of all life sciences IPOs by US issuers.

While the number of venture-backed New England IPOs decreased from 12 in 2015 to nine, the region accounted for 23% of all US-issuer VC-backed IPOs in 2016—the third-highest figure in the last fifteen years, falling just behind the region's 25% market share in both 2007 and 2014.

At year-end, the average New England IPO was up 19% from its offering price, led by Acacia Communications (up 168% at year-end)—the nation's best-performing IPO of 2016 based on the year-end gain from its offering price. The region's top performer in first-day trading was Syros Pharmaceuticals, up 45% from its offering price. Another highlight was the IPO of Editas Medicine in early February, which ended a nationwide offering drought of nearly eight weeks to produce the first IPO of 2016.

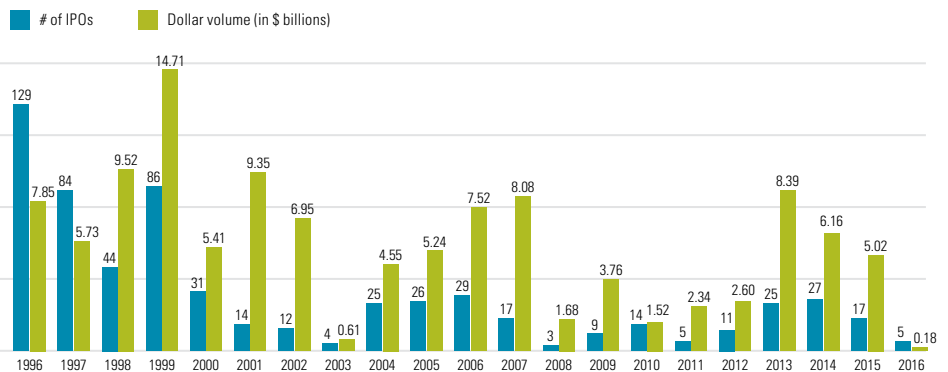
With the region's world-renowned universities and research institutions serving as incubators for emerging tech and life sciences companies, and with strong levels of venture capital investment, New England should continue to generate attractive IPO candidates in the coming year.

New England IPOs – 1996 to 2016



Source: SEC filings

Tri-State IPOs – 1996 to 2016



Source: SEC filings

TRI-STATE

The number of IPOs in the tri-state region of New York, New Jersey and Pennsylvania declined by 71%, from 17 in 2015 to five in 2016—the region's lowest level since 2011.

New York produced three of the region's 2016 IPOs, with New Jersey accounting for the remaining two. For the first time since the height of the financial crisis in 2008, Pennsylvania failed to produce a single IPO.

Gross proceeds from tri-state IPOs declined 96%, from \$5.02 billion in 2015 to \$184 million in 2016, influenced heavily by the size discrepancy between the region's largest 2015 IPO—the First Data offering, with \$2.56 billion in proceeds—and its largest 2016 IPO—the Kadmon offering, with \$75 million in proceeds.

The next largest tri-state IPOs of 2016 came from Tabula Rasa HealthCare (\$52 million) and Oncobiologics (\$35 million).

Four of the region's IPOs in 2016 were by life sciences companies, with the remaining one a healthcare technology company.

The average tri-state IPO in 2016 ended the year down 21% from its offering price, with all four of the region's life sciences company IPOs broken on their first day and none making it above their offering price by year-end.

Despite the slower pace of IPOs in 2016, venture capital activity in the tri-state region now trails only that of California, and the coming year should see increased deal flow, especially from the life sciences and technology sectors. ■

8 Some Facts About the IPO Market

PROFILE OF SUCCESSFUL IPO CANDIDATES

What does it really take to go public?

There is no single profile of a successful IPO company, but in general the most attractive candidates have the following attributes:

- Outstanding Management:** An investment truism is that investors invest in people, and this is even truer for companies going public. Every company going public needs experienced and talented management with high integrity, a vision for the future, lots of energy to withstand the rigors of the IPO process, and a proven ability to execute.
- Market Differentiation:** IPO candidates need a superior technology, product or service in a large and growing market. Ideally, they are viewed as market leaders. Appropriate intellectual property protection is expected of technology companies, and in some sectors patents are *de rigueur*.
- Substantial Revenue:** With some exceptions, substantial revenue is expected—at least \$50 million to \$75 million annually—in order to provide a platform for attractive levels of profitability and market capitalization.
- Revenue Growth:** Consistent and strong revenue growth—25% or more annually—is usually needed, unless the company has other compelling features. The company should be able to anticipate continued and predictable expansion to avoid the market punishment that accompanies revenue and earnings surprises.
- Profitability:** Strong IPO candidates generally have track records of earnings and a demonstrated ability to enhance margins over time.
- Market Capitalization:** The company's potential market capitalization should be at least \$200 million to \$250 million, in order to facilitate development of a liquid trading market. If a large portion of the company will be owned by insiders following the IPO, a larger market cap may be needed to provide ample float.


How Do You Compare?

Set forth below are selected metrics about the IPO market, based on combined data for all US IPOs from 2013 through 2016.

Percentage of IPO companies qualifying as EGCs under JOBS Act	86%
Median offering size	\$98.5 million (17% below \$50 million and 9% above \$500 million)
Median annual revenue of IPO companies	\$64.5 million (45% below \$50 million and 20% above \$500 million)
Percentage of IPO companies that are profitable	36%
State of incorporation of IPO companies	Delaware—94% No other state over 1%
Percentage of IPOs including selling stockholders, and median percentage of offering represented by those shares	Percentage of IPOs—25% Median percentage of offering—32%
Percentage of IPOs including directed share programs, and median percentage of offering represented by those shares	Percentage of IPOs—39% Median percentage of offering—5%
Percentage of IPO companies disclosing adoption of ESPP	45%
Percentage of IPO companies using a "Big 4" accounting firm	80%
Stock exchange on which the company's common stock is listed	Nasdaq—64% NYSE—36%
Median underwriting discount	7%
Number of SEC comments contained in initial comment letter	Median—31 25th percentile—24 75th percentile—42
Median number of Form S-1 amendments (excluding exhibits-only amendments) filed before effectiveness	Five
Time elapsed from initial confidential submission to initial public filing of Form S-1 (EGCs only)	Median—67 calendar days 25th percentile—45 calendar days 75th percentile—109 calendar days
Time elapsed from initial confidential submission (if EGC) or initial public filing to effectiveness of the Form S-1	Median—118 calendar days 25th percentile—91 calendar days 75th percentile—175 calendar days
Median offering expenses	Legal—\$1,500,000 Accounting—\$850,000 Total—\$3,200,000

Other factors can vary based on a company's industry and size. For example, many life sciences companies will have much smaller revenue and not be profitable. More mature companies are likely to have greater revenue and market caps, but slower growth rates. High-growth companies are likely to be smaller, and usually have a shorter history of profitability.

Beyond these objective measures, IPO candidates need to be ready for public ownership in a range of other areas, including accounting preparation; corporate governance; financial and disclosure controls and procedures; external communications; legal and regulatory compliance; and a variety of corporate housekeeping tasks. ■

 The cornerstone of the JOBS Act is the creation of an “IPO on-ramp” that provides “emerging growth companies” (EGCs) with a phase-in period, which can last until the last day of the fiscal year following the fifth anniversary of an IPO, to come into full compliance with certain disclosure and accounting requirements. Although the overwhelming majority of all IPO candidates qualify as EGCs, the extent to which EGC standards are being adopted in IPOs varies. Moreover, practices differ between life sciences companies and other types of IPO companies.

EGC REVENUE THRESHOLD INCREASED

The JOBS Act requires the maximum annual revenue for EGC eligibility to be adjusted for inflation every five years. In April 2017, the maximum annual revenue was increased from \$1 billion to \$1.07 billion.

CONFIDENTIAL SUBMISSION OF FORM S-1

An EGC is able to submit a draft Form S-1 registration statement to the SEC for confidential review instead of filing it publicly on the SEC’s EDGAR system. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements and signed audit reports. The SEC review process for a confidential submission is the same as for a public filing. A confidentially submitted Form S-1 must be filed publicly no later than 15 days before the road show commences.

Confidential submission enables an EGC to maintain its IPO plans in secrecy and delay disclosure of sensitive information to competitors and employees until much later in the process. Depending on the timing, confidential review also means that the EGC can withdraw the Form S-1 without any public disclosure at all if, for example, the SEC raises serious disclosure issues that the EGC does not want made public or market conditions make it apparent that an offering cannot proceed. Confidential submission will, however, delay any perceived benefits of public filing, such as the attraction of potential acquirers in a “dual-track” IPO process.

REDUCED FINANCIAL DISCLOSURE

EGCs must provide only two years of audited financial statements (instead of three years), plus unaudited interim financial statements, and need not present selected financial data for any period prior to the earliest audited period (instead of five years). Similarly, an EGC is only required to include MD&A for the periods presented in the required financial statements.

Some investors prefer to continue to receive three full years of audited financial statements and five years of selected financial data, and an EGC may be disadvantaged if it provides less financial information than its non-EGC peers. These deviations from historical norms are more likely to be acceptable to investors in the case of EGCs for which older financial information is largely irrelevant, such as startups in the life sciences industry.

ACCOUNTING AND AUDITING RELIEF

EGCs may choose not to be subject to any accounting standards that are adopted or revised on or after April 5, 2012, until these standards are required to be applied to nonpublic companies. This election must be made on an “all or nothing” basis, and a decision not to adopt the extended transition is irrevocable. Although appealing, this decision could make it difficult for investors to compare a company’s financial statements to those of its non-EGC comps, and could make it harder for a company to transition out of EGC status. Moreover, the benefits are difficult to assess, as it is hard to predict which accounting standards will be affected in the future.

In addition, EGCs are automatically exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company (a so-called auditor discussion and analysis) that the PCAOB might adopt. Any other new auditing standards will not apply to audits of EGCs unless the SEC determines that application of the new rules to audits of EGCs is necessary or appropriate in the public interest. To date, the SEC has applied all new auditing standards to audits of EGCs.

REDUCED EXECUTIVE COMPENSATION DISCLOSURE

An EGC need not provide Compensation Discussion and Analysis (CD&A); compensation information is required only for three named executive officers (including the CEO); and only three of the seven compensation tables otherwise required must be provided. Investors generally appear willing to accept reduced compensation disclosures in IPOs.

SECTION 404(B) EXEMPTION


EGCs are exempt from the requirement under Section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company’s internal control over financial reporting (ICFR), beginning with the company’s second Form 10-K. Most EGCs are adopting this exemption at the time it becomes applicable to them, although the decision need not be disclosed in advance in the Form S-1. ■

EGC Elections

Based on IPOs initiated after enactment of the JOBS Act and completed by EGCs through 2016, below are the rates of adoption with respect to several key items of EGC relief:

ITEM	LIFE SCIENCES COMPANIES	TECH COMPANIES	OTHER COMPANIES
Confidential submission of Form S-1	95%	95%	87%
Two years of audited financial statements	87%	37%	58%
Deferred application of new or revised accounting standards	10%	12%	13%
Omission of CD&A	100%	98%	96%

10 Change and Continuity in Securities Regulation

 The election of Donald Trump as President and the continued Republican control of Congress raise questions as to what changes may be expected at the SEC and what may stay the same. President Trump has already nominated a new SEC chair—corporate lawyer Jay Clayton—and has two more commissioner openings to fill. Although President Trump has called for repeal of the Dodd-Frank Act, he has provided few specifics about possible changes to the federal securities laws and what role he expects the SEC to play. With the new Republican administration’s deregulatory focus and the House and Senate both under Republican control, there is the potential for significant changes in policy and direction to be implemented at the SEC.

Many key components of securities regulation, however, will likely remain unchanged. Despite concerns about various aspects of the SEC’s approach to regulation and enforcement, both Republicans and Democrats appear to recognize the importance of the SEC’s role in maintaining the preeminence and integrity of the US securities markets. Accordingly, challenges to the SEC’s core focus are unlikely to develop. In addition, although the leadership at the SEC is changing, most of the experienced professional staff at the SEC likely will remain in place, thereby providing some continuity in how the SEC carries out its mission.

Below, we explore possible changes in key areas of securities regulation, including within the SEC’s Division of Corporation Finance (which oversees the review of all IPO filings and disclosure obligations of all public companies), that may be coming under the new administration.

MECHANISMS FOR CHANGE

The Trump Administration could seek to implement changes in securities regulation by asking Congress, with or without SEC involvement, to amend or replace the relevant statutes; adopt legislation to change SEC rules or regulations; and/or decrease or redirect the SEC’s budget. In addition, the new administration could advocate that the SEC amend or repeal existing or pending SEC rules and regulations; issue interpretive guidance; and/or change enforcement and other staff priorities.

The processes for changing statutes and regulations are complicated and generally time-consuming. Set forth below is a summary of the potential methods for making changes to existing requirements at the SEC.

- *Statutory Changes:* Congress could adopt new legislation to amend and/or replace existing statutes applicable to the SEC based on recommendations from the administration, from the SEC or on its own behalf. For example, the proposed CHOICE Act, which was introduced in the last Congress and passed by the House Financial Services Committee in September 2016, seeks to amend or repeal large portions of the Dodd-Frank Act. The adoption of new legislation would likely involve protracted and complicated negotiations both within the Republican Party and with Democrats, although it is always possible that some less controversial legislation could be adopted quickly.
- *Changes to Existing SEC Rules:*
 - The SEC could vote to repeal or amend previously adopted rules and regulations. Such a repeal or amendment would ordinarily be subject to the notice and comment process, as well as cost-benefit analyses in certain cases, and likely would take months to implement. The SEC could invoke the “good cause” exception to notice and comment (reserved essentially for emergencies) to accomplish a rule change immediately. Nevertheless, the SEC would have to show a compelling reason to dispense with the public notice and comment period if challenged. It also may be possible for the SEC to propose repeal of a current rule and, at the same time, announce that it will not enforce the rule until the new rulemaking is complete. The SEC also could adopt rules on a temporary basis, while seeking comment (for example, an interim final rule suspending certain requirements). Similarly, for rules that have been adopted but have not yet taken effect, or whose compliance dates have not yet been reached, the SEC could extend effective dates to provide it time to conduct a notice and comment rulemaking. An indefinite suspension of a rule could raise legal issues under the Administrative Procedures Act and might be challenged in court.
 - Congress also could repeal or amend any SEC regulation by adopting new legislation to make such a change. The process for adopting new legislation is the same as discussed above. In addition, subject to certain limitations, the Congressional Review Act establishes certain time periods during which Congress can review and disapprove a final rule. The new Congress has already acted on this basis to repeal several regulatory requirements, and is pursuing repeal of other regulations.
- *Changes to SEC Guidance and Interpretations:* The SEC may also issue guidance and interpretations, which are not subject to a notice and comment period as long as they do not amount to a “legislative rule”:
 - In determining whether “guidance” or an “interpretation” voted on by the SEC is a legislative rule requiring notice and comment on the one hand, or a policy statement or interpretive rule not requiring notice and comment on the other, a court will look to the actual legal effect of SEC action and the SEC’s own characterization of its action. A court also will consider whether the SEC action creates a substantial regulatory change. Adoption of a binding norm will likely be classified as a legislative rule. A statement on how the SEC intends to enforce an existing legal norm will probably be regarded as a policy statement. A construction of an existing norm is likely to be classified as an interpretive rule. Therefore, as long as the SEC does not adopt new binding norms for a rule, issuing new guidance and interpretations could be done more expeditiously than changes to the rule itself.
 - The CHOICE Act contains provisions that would prohibit the SEC from voting on any interpretation or guidance without conducting formal notice and comment. Given that the CHOICE Act originally was offered under a Democratic administration, however, a Republican administration may not reintroduce this provision, because Congress may not want to constrain the new leadership of the

SEC. On the other hand, Congress and others tend to object to what they view as rulemaking through interpretation by an independent agency, so the approach in the CHOICE Act may reappear in new legislation.

- The SEC staff also could change the SEC's direction through issuance of guidance on which the commissioners do not vote. Staff-issued guidance, such as "FAQs" often published regarding a new rule, would not amount to a legislative rule. In general, however, new leadership brought in by the new SEC chair would be unlikely to change course on matters of significance without at least seeking concurrence from the SEC chair. Moreover, certain Republicans have criticized "informal rulemaking" by the SEC staff through means such as enforcement decisions, no-action letters or accounting guidance, rather than statutorily mandated procedures, thereby raising the question as to whether such methods will continue to be utilized.

DIVISION OF CORPORATION FINANCE

In the wake of the election, there may be changes in the specific subject areas governed by, and the priorities of, the Division of Corporation Finance:

- *Financial Reporting Regulations:* The SEC has been engaged in efforts to improve and modernize financial reporting and has sought public comment on how to prioritize the information companies disclose to better serve investors. At the same time, the FAST Act directed the SEC to study Regulation S-K and issue a report to Congress containing, among other things, "specific and detailed recommendations on modernizing and simplifying [disclosure requirements] in a manner that reduces the costs and burdens on companies while still providing all material information." The SEC issued the report on November 23, 2016, and is required to propose regulations to implement its recommendations within one year after issuance of the report. In light of the FAST Act, disclosure effectiveness and simplification efforts may well continue under the new SEC leadership, although the focus may shift more dramatically toward reducing regulatory burdens.

- *Corporate Disclosure Rules:* Certain enhanced corporate disclosure requirements for public companies that have been proposed or are under consideration at the SEC are likely to be reconsidered under new leadership:


- *Pay Ratio Disclosure.* In 2015, as required by the Dodd-Frank Act, the SEC adopted amendments to Item 402 of Regulation S-K to require public companies to disclose the median of the annual total compensation of all their employees (excluding the CEO), the annual total compensation of their CEO, and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the CEO. The rule change becomes effective in 2017. This provision of the Dodd-Frank Act and the corresponding rule, which would be repealed by the CHOICE Act, are likely to be reconsidered by the Trump Administration. The SEC's Acting Chairman Michael S. Piwowar has already announced—in early February—that he is seeking public comment on challenges that companies have experienced as they prepare for compliance with the rule, and has directed the staff to reconsider the implementation of the rule based on any comments submitted.
- *Conflict Minerals Disclosure.* In 2012, as directed by the Dodd-Frank Act, the SEC adopted rules requiring public companies to publicly disclose their use of conflict minerals that originated in the Democratic Republic of the Congo or an adjoining country. This disclosure rule is anticipated to receive new scrutiny with the change in the administration. In late January, Acting SEC Chairman Piwowar directed the staff to reconsider whether certain guidance on the conflict minerals rule is still appropriate and whether any additional relief would be appropriate. A similar rule regarding resource extraction was repealed under the Congressional Review Act in February 2017.
- *Political Spending Disclosure.* Certain Democrats and investor groups have urged the SEC to require public companies to disclose their political spending. Such a rule, which already

was not an SEC priority, is highly unlikely to be proposed or adopted in the new political environment.

- *Focus on Smaller Companies:* Certain Republicans have been strong proponents of amending the SEC regulatory regime to take into consideration the needs of smaller companies, including tailoring market structure requirements and disclosure rules to make the requirements more user friendly for smaller companies. Similarly, the CHOICE Act includes provisions intended to assist smaller companies, including an increase in the thresholds for requiring audits of internal control over financial reporting. Going forward, it is likely that the SEC, under new leadership, will place more emphasis on reducing compliance costs and increasing access to capital for smaller companies.
- *Executive Compensation:* The three remaining corporate finance governance and compensation-related rulemaking mandates from the Dodd-Frank Act that have been proposed but not adopted by the SEC relate to: pay-for-performance (requiring disclosure regarding the relationship between executive compensation and total shareholder return); hedging (requiring disclosure of hedging activities by corporate employees and directors); and clawbacks (requiring disgorgement of incentive compensation paid to executive officers during the three-year period preceding a financial restatement caused by material noncompliance with financial reporting requirements). We expect that these rule proposals likely will not move forward in their current form, and may become moot if Congress eliminates the rulemaking mandates. The CHOICE Act would repeal or amend Dodd-Frank provisions and related rules regarding disclosure of hedging activities, clawbacks of executive compensation, and the frequency of required "say-on-pay" shareholder votes on executive compensation.

CONCLUSION

It is impossible to predict what the SEC's agenda will look like after the appointment of a new chair and two new commissioners. What is clear is that there is likely to be a different regulatory approach on a number of fronts. ■

 As we mark the twentieth anniversary of our *IPO Report*, we couldn't help but step back and reflect on changes in the IPO process over the past two decades.

From a distance, the IPO process has scarcely changed: You gather at an organizational meeting, hold multiple drafting and diligence sessions, prepare a Form S-1, meet at a financial printer to file the Form S-1 with the SEC, resolve SEC comments, pitch investors on a road show, price the offering, sign the underwriting agreement, finalize the prospectus, and then close the deal. Even the 7% underwriting discount for firm-commitment IPOs is still firmly ensconced, except on larger deals. But below 30,000 feet, many things have changed—particularly in light of the JOBS Act.

MORE EXTENSIVE PREPARATION

Far more preparation—legal, accounting, financial, governance, investor relations and organizational—is now required for an IPO, and more of the work comes earlier in the process. IPO candidates used to select a managing underwriter and hold an organizational meeting to kick off the IPO process, with little advance preparation. Now, if the company has not invested several months or more in getting ready to go public, the IPO schedule will lag behind underwriter expectations as well as the pace of other companies in the IPO queue.

ADDITIONAL DISCLOSURE REQUIREMENTS

Disclosure requirements have mushroomed. Companies need to provide much more extensive and elaborate disclosure in areas such as Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A); executive compensation; risk factors; and the financial statements and footnotes. Much of this additional disclosure stems from new and expanded SEC rules (sometimes mandated by federal legislation), but some simply reflects more demanding investor expectations. As a result of these changes, prospectuses have ballooned in length, routinely exceeding 200 pages (including financial statements) and requiring summaries of five to ten pages or more.

ACCOUNTING CHANGES

Accounting issues have assumed unprecedented importance since the enactment of the Sarbanes-Oxley Act. Auditors have become more cautious and risk-averse; audits take longer and cost more; the SEC has become more active in accounting standard-setting and less deferential to companies and their auditors on judgment calls; and new accounting and auditing requirements abound. Among many important rule changes, “non-GAAP financial measures”—which are now frequently included in IPO prospectuses—must be reconciled to GAAP results and presented in a manner that is balanced, that gives equal or greater prominence to the corresponding GAAP measure, and that is not misleading.

PLAIN ENGLISH

SEC rules now require prospectuses to be written in “plain English” complying with the principles of short sentences; definite, concrete, everyday words; active voice; tabular presentation or bullet lists for complex material, whenever possible; no legal jargon or highly technical business terms; and no multiple negatives.

LENGTHIER (BUT MORE TRANSPARENT) SEC REVIEW

With more information presented in the Form S-1, SEC review takes longer. It used to be possible to clear all SEC comments after only one or two comment letters. Now, four or more sets of comments are typical, and it is almost unheard of to print preliminary prospectuses and begin a road show based on the initial Form S-1 filing or the company's response to the first comment letter alone. The SEC now publicly releases comment letters and company responses shortly after completing its review of registration statements, providing more visibility into the SEC review process.

CHANGES IN UNDERWRITING AND OFFERING PRACTICES

IPOs with joint bookrunners now represent the majority of all offerings. Most IPOs now have three or four managing underwriters, but syndicates have become much smaller. Road shows frequently

include trips to Europe and often utilize charter airplanes to reduce wear and tear on the company's executives and permit tighter scheduling. Marketing reach is expanded with electronic road shows. Since 2002, the roles of investment bankers and research analysts in the offering process have been separated. Free writing prospectuses can now be used to update information without recirculating a revised preliminary prospectus. Lockup agreements in IPOs almost universally last 180 days, and lockup releases for directors and officers must be publicly announced at least two business days in advance.

NEW EXCHANGES AND OFFERING FORMATS

Nasdaq is now a “national securities exchange”; the Nasdaq National Market has been segmented into the Nasdaq Global Market and the Nasdaq Global Select Market; and the Nasdaq SmallCap Market has been reborn as the Nasdaq Capital Market. The New York Stock Exchange has added NYSE MKT (the former American Stock Exchange) for small growth companies to compete with Nasdaq for IPO listings. Both Nasdaq and the NYSE have become larger and more global through acquisitions, and each is now operated by a public company. In all markets, online and auction formats have grown with the expansion of the Internet, although they account for only a tiny fraction of the overall IPO market.

LONGER TIMELINE

The overall IPO timeline has stretched markedly. Prior to 2000 or so, an IPO candidate could reasonably expect to complete its IPO within 45 to 60 days after the initial filing. Today's norm is twice that. The longer the IPO process, the more opportunities for the offering to be delayed or scuttled due to poor market conditions or adverse company developments, causing many proposed IPOs to proceed in fits and starts and resulting in many more Form S-1 withdrawals than historically were seen.

STREAMLINED FILING AND PRICING

The SEC's EDGAR system has made filing simpler, and the information contained in EDGAR filings is instantly available to everyone with Internet access. The format

of EDGAR submissions has become more reader-friendly, and a next-generation EDGAR system has been launched. Rule 430A under the Securities Act permits a Form S-1 to be declared effective without including final pricing information, eliminating the need to file a “pricing amendment.” Rule 462(b) provides for immediate registration of additional shares, allowing an IPO to be readily upsized by up to 20% in aggregate gross proceeds.

HEIGHTENED SCRUTINY AND POTENTIAL LIABILITY

Each director can be held liable for a material misstatement or omission in the Form S-1 unless he or she is able to demonstrate that, after reasonable investigation, he or she had reasonable grounds to believe that there was no such misstatement or omission. Following an IPO, a company’s directors and officers signing a periodic SEC report can likewise be held liable for a material misstatement or omission in the report. Conduct of directors and officers is increasingly scrutinized, and the company’s CEO and CFO are required to provide personal certifications in connection with each Form 10-Q and Form 10-K. Willful false certifications can result in fines of up to \$5 million and imprisonment for up to 20 years.

MORE DEMANDING AND COMPLEX INVESTOR RELATIONS

A newly public company enters a world of largely unfamiliar and often time-consuming investor relations responsibilities. Investor relations expectations have become more demanding and the legal and cultural environment more complex. Quarterly earnings calls are now standard practice but have not replaced one-on-one calls and meetings. Institutional investors increasingly demand direct board-stockholder engagement on governance and other matters. All investor communications must pass muster under Regulation FD (which prohibits selective disclosure of material nonpublic information to analysts or stockholders). Social media, which barely existed ten years ago, is now an essential component of effective investor relations as well as a tool that can

be used against a company by financial activists and dissident stockholders.

OTHER REGULATORY CHANGES

The NASD has combined with the member regulation, enforcement and arbitration functions of the NYSE to form the Financial Industry Regulatory Authority (FINRA), the principal self-regulatory organization for securities firms in the United States. State securities “blue sky” regulation of IPOs has been largely preempted. The accounting profession is now regulated by the Public Company Accounting Oversight Board (PCAOB), which in turn is overseen by the SEC.

THE JOBS ACT

Enacted on April 5, 2012, the JOBS Act effected profound changes to the securities laws, with broad implications for pre-IPO companies and the conduct of IPOs, as well as for public companies. Perhaps most importantly, the JOBS Act created an “IPO on-ramp” that permits EGCs to:

- submit a draft Form S-1 to the SEC for confidential review (the Form S-1 and all amendments must be filed publicly no later than 15 days before the road show commences);
- provide reduced financial statement, MD&A, selected financial data and executive compensation disclosures;
- choose not to be subject to any accounting standards that are adopted or revised on or after April 5, 2012, unless and until these standards are required to be applied to nonpublic companies; and
- engage in oral or written “test-the-waters” communications with eligible institutional investors to determine their investment interest in a contemplated IPO, either prior to or following the date of filing of the Form S-1.

EGCs are also exempt from the Dodd-Frank Act requirement to seek stockholder approval of “say-on-pay” advisory votes on executive compensation arrangements; the requirement under Section 404(b) of the Sarbanes-Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company’s internal control over financial reporting; and certain future auditing standards adopted by the PCAOB. ■

A BRIEF GUIDE TO SELECTED IPO TERMINOLOGY, OLD AND NEW

- *Bookrunner*—lead managing underwriter primarily responsible for organizing and conducting the road show, building the “book” of orders, and agreeing with the company on the price and size of the IPO
- *Comfort*—written assurances, based on specified procedures but not constituting an audit, provided by the company’s auditor to the underwriters with respect to financial information and other numerical measures derived from the company’s accounting records and contained in the prospectus
- *Confidential submission*—submission by an EGC of draft Form S-1 for confidential SEC review
- *DRS*—“draft registration statement” confidentially submitted by EGC to SEC
- *EGC*—“emerging growth company” under the JOBS Act, generally defined as a company with total annual gross revenues of less than \$1.07 billion (increased from \$1 billion in April 2017)
- *FWP*—written communication that is used to correct or supplement information contained in a statutory prospectus (stands for “free writing prospectus”)
- *Green shoe*—option granted by the company and/or selling stockholders that permits the underwriters to purchase additional shares (up to 15% of the IPO), at the IPO price
- *Lockup*—agreement with underwriters prohibiting a stockholder from selling shares acquired prior to the IPO for a specified period of time following the IPO (typically 180 days)
- *Red herring*—preliminary prospectus containing the estimated price range and number of shares offered, distributed to potential investors in road show meetings
- *Road show*—meetings held by the managing underwriters and company management with prospective investors to market shares in an IPO
- *Staff*—SEC staff employees, including lawyers, accountants, financial analysts, economists, engineers, investigators and administrative employees

Perhaps the most vexing part of the IPO journey for management is the “quiet period,” during which a company must rein in its publicity activities. Lawyers lecture their clients about the rules, underwriters fret over the consequences of a misstep, and companies chafe at the restrictions.

LEGAL BACKGROUND

Section 5 of the Securities Act of 1933 is generally intended to ensure that written offers and sales of securities are made only pursuant to a prospectus meeting all SEC disclosure requirements. The SEC has broadly construed the term “offer” to include many types of public communications that have the intent or effect of promoting a company to prospective investors or otherwise eliciting interest in the company or its securities. Section 5 therefore limits a company’s ability to publicly release information about itself or otherwise engage in promotional activities—for example, through press releases, media interviews or website postings—even if the communications do not reference the company’s contemplated IPO.

Section 5 has the effect of imposing a quiet period on a company throughout the IPO process. The quiet period ends 25 days after the IPO offering date. As a general rule, the quiet period is considered to commence not later than the organizational meeting, and probably as early as the company’s selection of the lead managing underwriters.

The quiet period is divided into three parts, with different restrictions applicable to each. Notwithstanding these restrictions, an emerging growth company (EGC) is permitted to engage in oral and written “test-the-waters” communications with eligible institutional investors at any time during the IPO process.

Pre-Filing Period

Prior to filing the Form S-1 registration statement, a company is prohibited from making any offers—whether oral or written—to sell its securities. The confidential submission of a draft Form S-1 to the SEC by an EGC does not constitute the filing of a Form S-1 for these purposes.

Waiting Period

During the period of time between the Form S-1’s filing and its effectiveness (which usually occurs shortly before pricing), a company cannot effect any sales, but it can make:

- oral offers (such as statements made during road show presentations); and
- written offers by means of a preliminary prospectus that contains an estimated offering price range and meets other SEC rules, or pursuant to a written communication called a “free writing prospectus.”

Post-Offering Period

During the period beginning on the offering date and ending 25 days later, oral offers remain permissible, written offers may be made, and sales may be effected.

PERMISSIBLE COMMUNICATIONS

Several SEC safe harbors provide some relief to companies during the quiet period:

Rule 163A—Communications More Than 30 Days Before Public Filing

Rule 163A establishes a broad exemption from quiet period restrictions for communications made more than 30 days prior to the initial public filing of the Form S-1 if:

- the communication is made by or on behalf of the company (communications by underwriters and other IPO participants do not qualify);
- the communication does not reference the IPO; and
- the company takes reasonable steps to prevent the communicated information from being further distributed during the period beginning 30 days prior to public filing and ending 25 days after the offering date (for example, by inquiring about the publication schedule before agreeing to an interview).

Rule 169—Factual Business Communications

Rule 169 enables a company to continue to disseminate regularly released, ordinary course information both prior to and during the IPO process if the communication:

“TEST-THE-WATERS” COMMUNICATIONS

Under the JOBS Act, an EGC or any person authorized to act on its behalf may engage in oral or written “test-the-waters” communications with potential investors that are “qualified institutional buyers” (as defined in Rule 144A) or institutions that are “accredited investors” (as defined in Regulation D) to determine whether such investors might have an interest in a contemplated securities offering. “Test-the-waters” communications are permitted at any time during the IPO process.

When engaging in “test-the-waters” communications, the company should assume that the SEC staff, as part of its review of the Form S-1, will request copies of any written materials or presentation slides used in conjunction with such communications (even if copies are not provided to potential investors).

- consists of factual information about the company, its business or financial developments, or other aspects of its business, or advertisements and other information concerning the company’s products or services;
- is of a type regularly released by the company in the ordinary course of business;
- is released or disseminated by employees or agents of the company who historically have provided the information;
- is consistent in all material respects with similar past releases or disseminations in terms of timing, manner and form of release or dissemination;
- does not include information about, and is not released in connection with, the IPO; and
- is intended for use by persons (such as customers, suppliers or business partners) other than investors or potential investors in the company.

Rule 169 does not cover “forward-looking” statements, such as financial forecasts or information about future plans, expectations or objectives.

Rule 135—Announcement of Intent to Conduct Public Offering Before Filing Registration Statement

Rule 135 permits a public announcement that a company is planning a public offering. The announcement must include specified disclaimers and legends, and be limited to the following information:

- the name of the issuer;
- the title, amount and basic terms of the securities offered;
- the amount of the offering, if any, to be made by selling stockholders;
- the anticipated timing of the offering;
- a brief statement of the manner and purpose of the offering, without naming the underwriters; and
- whether the issuer is directing its offering to only a particular class of purchasers.

Rule 134—Announcement of Proposed Public Offering After Filing Registration Statement

Rule 134 permits a public announcement that a company proposes to make a public offering of securities. The announcement cannot be made until the company has publicly filed a registration statement for the offering, must include specified legends, and must be limited to:

- specified factual information about the legal identity and business locations of the company;
- a brief indication of the general type of business of the company;
- specified factual information about the terms of the offering, including the security offered, the anticipated offering timetable, the price or price range and the intended use of proceeds, and the identity of the underwriters;
- instructions for obtaining the preliminary prospectus, once available, and purchasing the shares offered; and
- procedural information for participation by the company's officers, directors and employees in a directed share program.

Price and price-related information must be excluded until an estimated offering price range has been disclosed in the Form S-1.

CONSEQUENCES OF VIOLATIONS

Violations of the quiet period restrictions can have various consequences, some imposed by the SEC and others self-imposed.

DETECTING VIOLATIONS

After a company files (or confidentially submits) a Form S-1 for an IPO, the SEC staff, as part of its review process, routinely conducts Internet searches on the company; browses its website; looks at press releases, newspapers and magazine stories mentioning the company; and reviews relevant industry publications and databases. This exercise sometimes detects potential violations of the quiet period restrictions.

If the SEC determines that a violation has occurred, several sanctions may be invoked:

- **Cooling-Off Period:** The SEC may impose a "cooling-off period" that forces the company to delay the IPO for a period of time determined by the SEC. Although infrequently imposed, a cooling-off period can jeopardize any IPO, given market volatility.
- **Rescission Risk Disclosure:** The company may be required to include "rescission risk disclosure" in its Form S-1—an acknowledgment that the company could be required to repurchase the shares sold in the IPO at the original offering price for a period of one year following the date of the violation.
- **Corrective Disclosure:** The company may be required to include as part of its Form S-1—and therefore assume legal responsibility for—the statements that were made in violation of quiet period restrictions, or to cite the impermissible public statements and explain why the statements are or may be inaccurate. This disclosure can be embarrassing and may require the prospectus to disclose projections or other forward-looking information that would not otherwise be included. The process of agreeing with the SEC on the exact wording of the disclosure could also delay the offering.

- **Civil Penalties:** The SEC can seek monetary penalties against a company and its directors and officers, or seek the imposition of a cease-and-desist order against future violations.

Apart from the possibility of SEC sanctions for violations, the effect of the quiet period rules is felt through the ongoing monitoring of public communications to avoid violations, the modification or curtailment of communications that would present concerns and, in some cases, self-imposed cooling-off periods—such as deliberately delaying the initial public filing of the Form S-1 for a period of 30 days so that a published article can qualify for the Rule 163A safe harbor.

PLANNING FOR THE QUIET PERIOD

































Careful planning can help a company avoid the mistakes that are commonplace—and potentially harmful to its IPO—while maintaining a program of necessary public communications. Important planning steps include:

- **External Communications Policy:** The company should adopt an external communications policy that designates the only representatives authorized to publicly communicate on behalf of the company, and instructs employees to refer external inquiries regarding the company to the authorized company spokespersons.
- **Legal Review:** Counsel should review all press releases prior to issuance and the company should consult with counsel before engaging in any other public communications.
- **Adherence to Established Disclosure Practices:** The company should adhere to an established and consistent pattern of routine disclosure practices. The Rule 169 safe harbor—which the company will rely on for most of its public communications beginning 30 days before the initial public filing of the Form S-1—is limited to factual business communications in the ordinary course of business that are consistent with past practices in timing, manner and form.
- **Coordination with Underwriters:** The company should review all proposed press releases and other publicity activities with the managing underwriters. ■

Counsel of Choice for Public Offerings

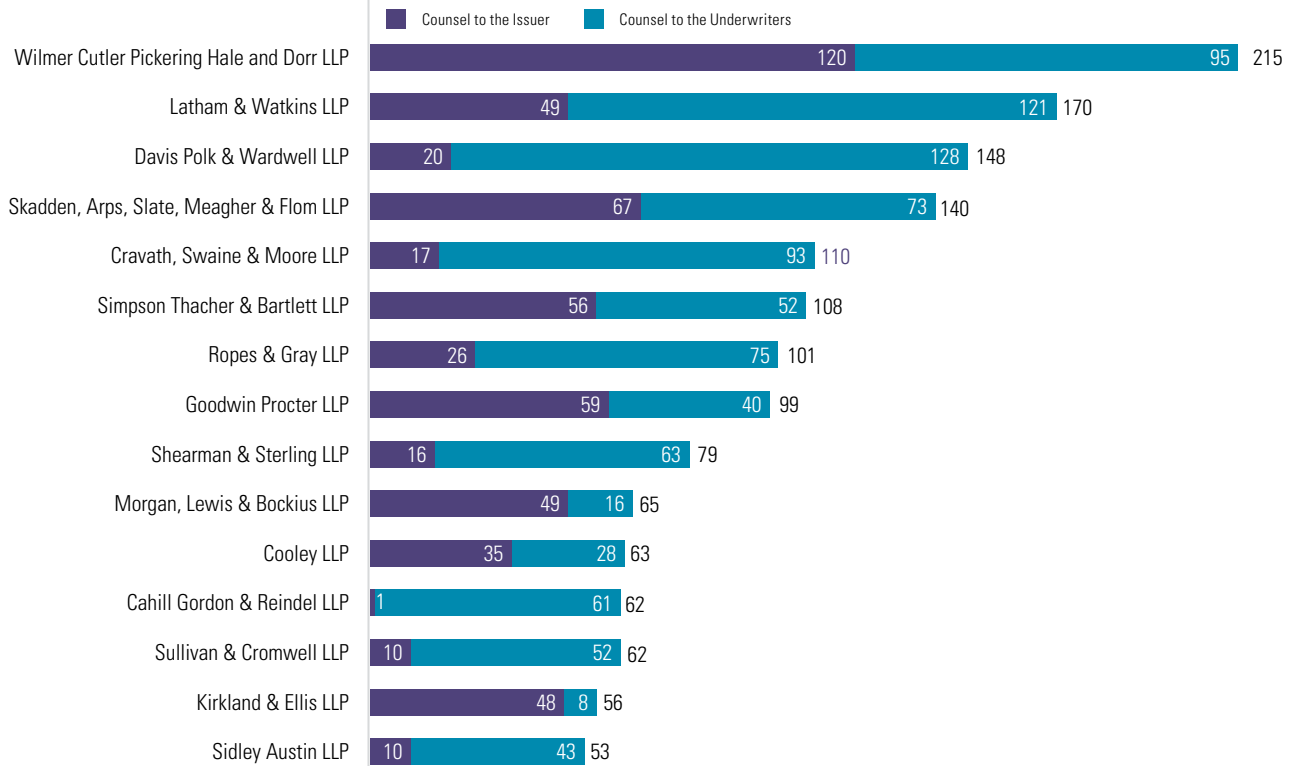
SERVING INDUSTRY LEADERS IN TECHNOLOGY, LIFE SCIENCES, ENERGY AND CLEANTECH, FINANCIAL SERVICES, COMMUNICATIONS AND BEYOND



 <p>Initial Public Offering of Common Stock \$119,025,000 Counsel to Issuer May 2016</p>	 <p>Public Offering of Common Stock \$181,125,000 Counsel to Issuer June 2016</p>	 <p>Public Offerings of 2.950% and 3.000% Senior Notes \$2,200,000,000 Counsel to Issuer April and September 2016</p>	 <p>Public Offerings of 2.000% and 2.125% Notes \$2,250,000,000 Counsel to Underwriters May and September 2016</p>	 <p>Public Offering of Common Stock \$172,500,000 Counsel to Issuer September 2016</p>	 <p>Public Offering of Common Stock \$50,000,000 Counsel to Issuer August 2016</p>	 <p>Initial Public Offering of Common Stock \$11,339,000 Counsel to Issuer May 2016</p>	 <p>Rule 144A Placement of 1.800%, 2.350%, 3.150% and 4.300% Senior Notes \$2,500,000,000 Counsel to Issuer June 2016</p>	
 <p>Public Offering of Common Stock \$11,500,000 Counsel to Issuer September 2016</p>	 <p>Public Offerings of Senior Notes \$2,000,000,000 Counsel to Issuers March 2017</p>	 <p>Public Offering of 3.25% Convertible Senior Notes \$460,000,000 Counsel to Issuer July 2016</p>	 <p>Public Offering of Common Stock \$50,000,000 Counsel to Issuer May 2016</p>	 <p>Public Offering of 3.800% and 4.900% Senior Notes \$650,000,000 Counsel to Issuer March 2017</p>	 <p>Public Offering of Common Stock \$138,000,000 Counsel to Issuer January 2016</p>	 <p>Public Offering of 1.875% Senior Notes €500,000,000 Counsel to Issuer July 2016</p>	 <p>Public Offering of Common Stock \$52,450,000 Counsel to Issuer October 2016</p>	 <p>Initial Public Offering of Common Stock \$60,000,000 Counsel to Issuer February 2015</p>
 <p>Public Offerings of Senior Notes and Senior Notes €2,700,000,000 \$2,000,000,000 Counsel to Issuer July and September 2015</p>	 <p>Initial Public Offering of American Depositary Shares representing Shares \$64,400,000 Counsel to Underwriters June 2015</p>	 <p>Public Offering of Common Stock \$50,000,000 Counsel to Issuer November 2016</p>	 <p>Public Offering of 2.500%, 3.125%, 3.500% and 4.500% Senior Notes \$2,100,000,000 Counsel to Issuer December 2016</p>	 <p>Rights Offering of Common Shares, including Common Shares represented by American Depositary Shares \$25,000,000 Counsel to Issuer December 2016</p>	 <p>Public Offerings of Common Stock \$65,000,000 Counsel to Issuer November 2016 and January 2017</p>	 <p>Public Offering of 1.450% Senior Notes €500,000,000 Counsel to Issuer March 2017</p>	 <p>Public Offering of Common Stock \$57,960,000 Counsel to Underwriters January 2017</p>	
 <p>Initial Public Offering of Common Stock \$57,500,000 Counsel to Issuer July 2016</p>	 <p>Public Offerings of Depositary Shares representing Non-Cumulative Perpetual Preferred Stock \$500,000,000 and 1.950% and 2.650% Senior Notes \$1,500,000,000 Counsel to Issuer April and May 2016</p>	 <p>Public Offering of Common Stock \$517,500,000 Counsel to Issuer October 2016</p>	 <p>Initial Public Offering of American Depositary Shares representing Ordinary Shares \$191,250,000 Counsel to Underwriters May 2015</p>	 <p>Public Offering of Common Stock \$86,990,000 Counsel to Issuer August 2016</p>	 <p>Public Offering of 3.500% Notes \$300,000,000 Counsel to Issuer April 2017</p>	 <p>Initial Public Offering of Common Stock \$108,560,000 Counsel to Issuer February 2016</p>		

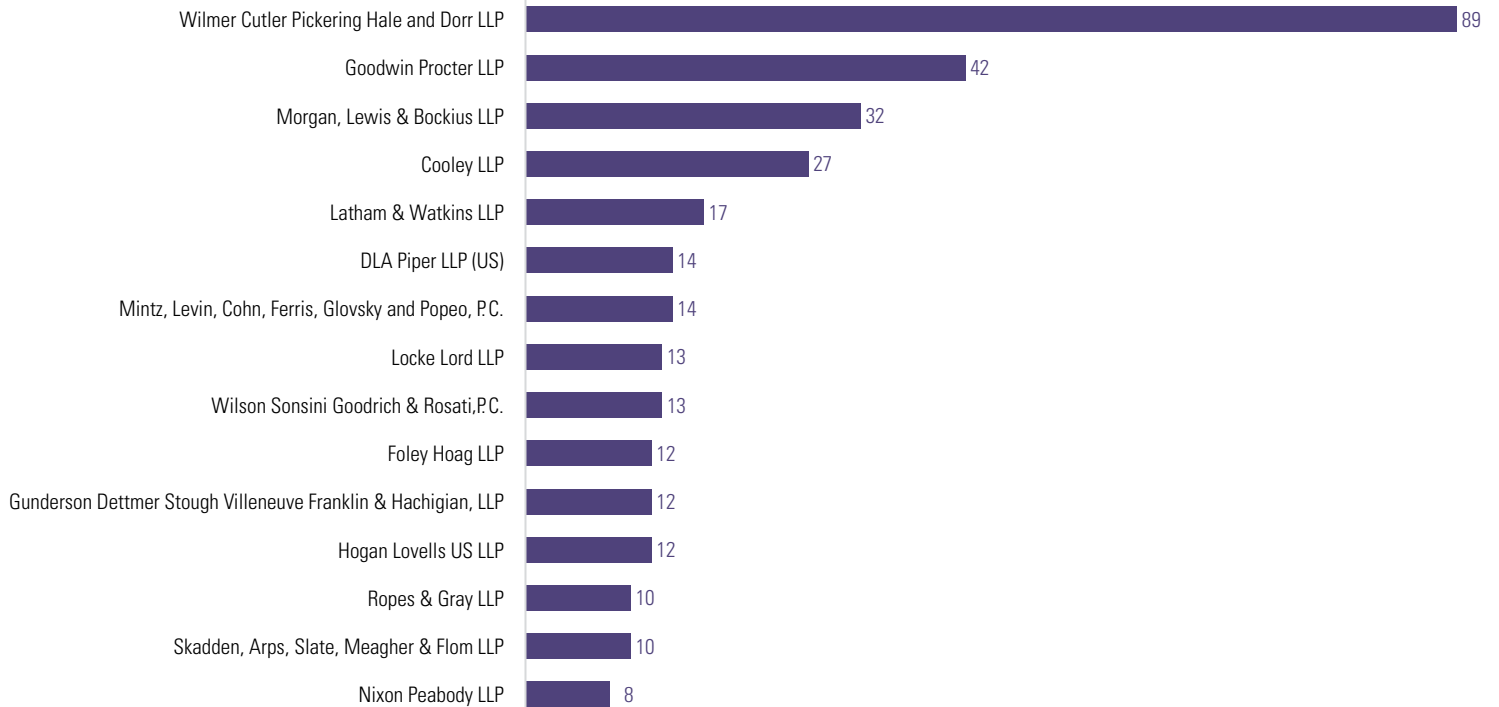
18 Law Firm Rankings

Eastern US IPOs – 1996 to 2016



Source: SEC Filings

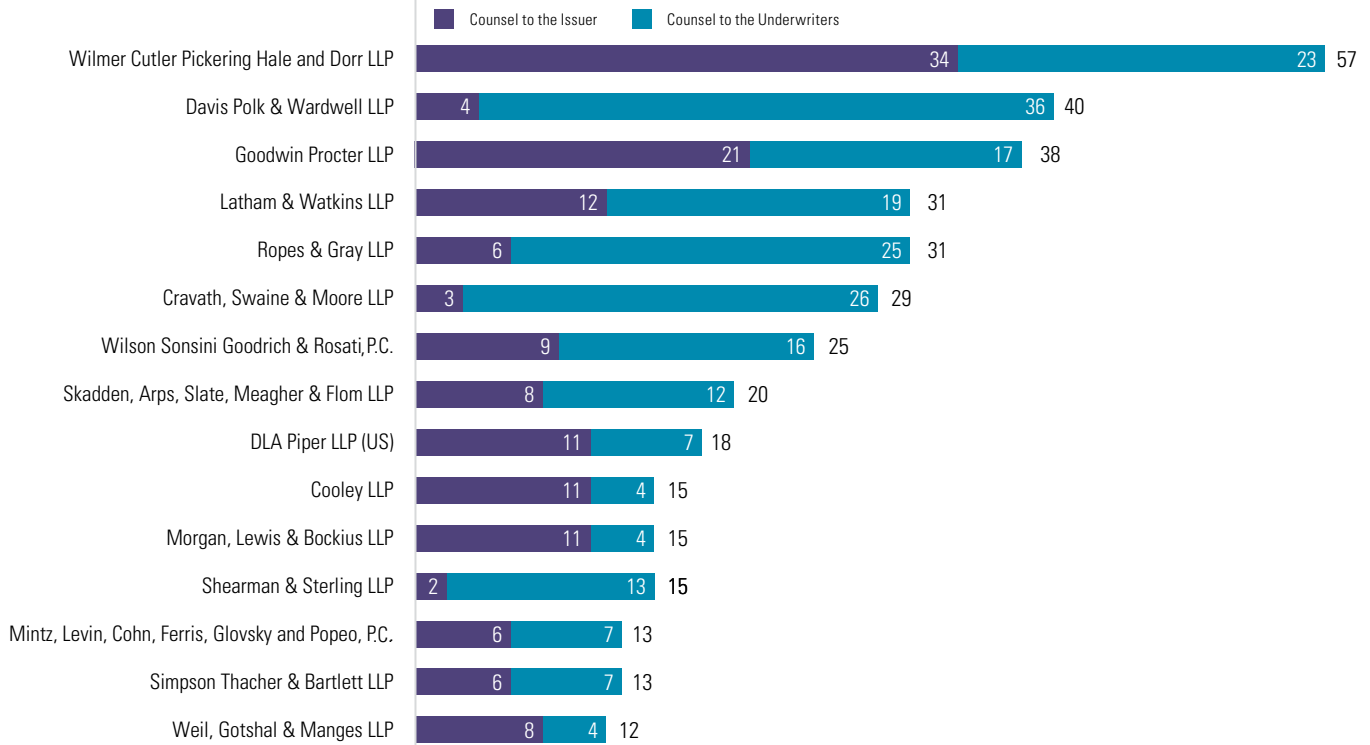
Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2016



Source: Dow Jones VentureSource and SEC Filings

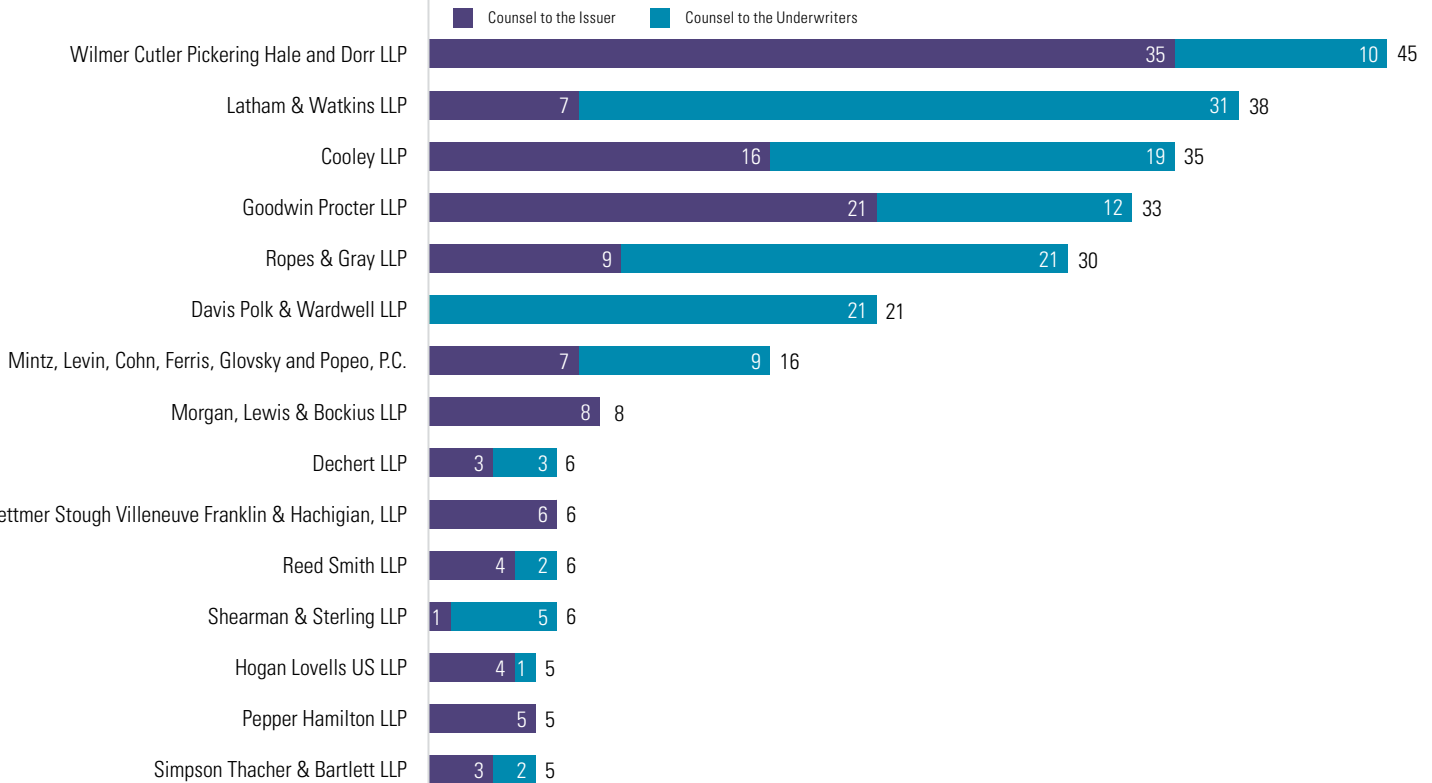
The above charts are based on companies located east of the Mississippi River.

Eastern US Technology Company IPOs – 2000 to 2016



Source: SEC Filings

Eastern US Life Sciences Company IPOs – 2004 to 2016



Source: SEC Filings

The above charts are based on companies located east of the Mississippi River.

During the past several years, there has been a growing divide between the corporate governance provisions adopted by companies going public compared to those maintained by established public companies. This is especially apparent when the governance practices of IPO companies are compared to those of companies in the S&P 500 index.

To some extent, perhaps even a great extent, the differences make sense and it is unlikely there will ever be complete convergence. However, newly public companies should expect to come under pressure from institutional investors and proxy advisory firms to begin to evolve their governance practices sooner than was the case in the past.

THE GREAT DIVIDE

The current divide in governance practices has more to do with the elimination by established public companies of previously standard provisions, often in response to direct or indirect pressure from stockholders and proxy advisory firms, than with an increased prevalence of these provisions among IPO companies.

The biggest gaps in governance practices relate to how the board of directors is elected, with more than 80% of companies going public in recent years continuing to adopt a classified board structure under which only one-third of the director seats are voted on by stockholders each year. In contrast, nearly 90% of S&P 500 companies provide for annual election of all directors, even though a majority of S&P 500 companies had classified boards as recently as 2006. Another example of the current split in practices is the vote standard applicable to electing directors, with a plurality vote standard continuing to be the norm among IPO companies while almost 90% of S&P 500 companies have adopted a majority vote standard. Prior to 2006, virtually no company had anything but a plurality standard in place.

Beyond the differences in adoption rates for the common anti-takeover provisions highlighted in the table to the right, differences also exist with respect to a number of other corporate governance

and compensation-related practices. For example, IPO companies are much less likely than established public companies to:

- allow proxy access (this practice is unheard of among IPO companies, whereas over half of S&P 500 companies now provide proxy access, up from a mere handful of public companies, of any size, prior to 2014);
- maintain limits on the number of other boards on which the company's directors and officers may serve (often referred to as an over-boarding policy);
- adopt a clawback policy for executive compensation;
- adopt minimum equity ownership requirements for directors and officers;
- grant performance-based equity awards (as opposed to equity awards that vest based solely on continued employment); or
- primarily rely on formulas, rather than discretion, to determine payouts under cash bonus programs.

Despite these differences, some practices remain commonplace across public companies, with more than 90% of IPO companies and more than 90% of S&P 500 companies imposing advance notice requirements and authorizing "blank check" preferred stock. In addition, exclusive forum provisions, which are a relatively recent phenomenon, are increasingly being adopted by both types of companies.

The incidence of dual- or multi-class capital structures is also reasonably consistent between IPO companies and established public companies, although much more recent attention has been focused on a handful of well-known companies going public with multi-class structures that include greater disparity in voting power among classes than historically seen.

IPO COMPANIES OFTEN FACE DIFFERENT CONSIDERATIONS

As a general matter, companies adopt takeover defenses in order to help:

Prevalence of Takeover Defenses Among IPO Companies and Established Public Companies

	IPO COMPANIES	ESTABLISHED PUBLIC COMPANIES S&P 500	RUSSELL 3000
Classified board	77%	11%	43%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	76%	21% to 41%, depending on type of action	18% to 57%, depending on type of action
Prohibition of stockholders' right to act by written consent	88%	71%	72%
Limitation of stockholders' right to call special meetings	94%	37%	51%
Advance notice requirements	95%	97%	91%
Section 203 of the Delaware corporation statute (not opt out)*	77%	95%	83%
Blank check preferred stock	96%	95%	94%
Multi-class capital structure	8%	9%	11%
Exclusive forum provisions*	59%	36%	38%
Stockholder rights plan	1%	3%	5%

*Delaware corporations only

Source: IPO company data is based on WilmerHale analysis of SEC filings from 2007 to 2016 (2011–2016 only for exclusive forum provisions) for US issuers. Established public company data is from SharkRepellent.net at year-end 2016.

- ensure stability and continuity in decision-making and leadership that will enable the company to focus on long-term value creation;
- provide the board with adequate time to evaluate and react in an informed manner to unsolicited acquisition proposals;
- provide negotiating leverage for the board; and
- maximize overall stockholder value by providing economic disincentives against inadequate, unfair or coercive bids.

The consideration of which takeover defenses to implement is somewhat different for IPO companies than for established public companies because:

- the need for takeover defenses may be greater given the IPO company’s state of development, high growth prospects and low market capitalization—any or all of which may make the company more vulnerable to a hostile takeover attempt;
- the existence of strong takeover defenses has not historically had an adverse effect on the marketing of IPOs; and
- anti-takeover provisions that need to be implemented in the corporate charter can be put in place easily prior to the IPO, but will be virtually impossible to adopt after the company is public.

Furthermore, in contrast to the profiles of many established public companies, the governance practices of IPO companies often reflect the high concentration of ownership that will continue to exist following the IPO; the more hands-on nature of the board of directors in place at the time of an IPO (which results in part from the meaningful ownership stakes that many directors hold); and the greater need for flexibility in designing compensation programs that goes hand-in-hand with the uncertainties inherent in companies pursuing new and innovative business models.

ENHANCED SCRUTINY AHEAD

Notwithstanding the different considerations faced by IPO companies, the governance practices of newly public companies have started to come under challenge sooner than in the past.

Differences in Anti-Takeover Practices Among Types of IPO Companies

	ALL IPO COMPANIES	VC-BACKED COMPANIES	PE-BACKED COMPANIES	OTHER IPO COMPANIES
Classified board	77%	88%	79%	49%
Supermajority voting requirements to approve mergers or change corporate charter and bylaws	76%	84%	79%	52%
Prohibition of stockholders’ right to act by written consent	88%	94%	91%	70%
Limitation of stockholders’ right to call special meetings	94%	97%	97%	82%
Advance notice requirements	95%	98%	98%	84%
Section 203 of the Delaware corporation statute (not opt out)*	77%	96%	40%	73%
Blank check preferred stock	96%	97%	99%	90%
Multi-class capital structure	8%	7%	5%	12%
Exclusive forum provisions*	59%	55%	68%	54%
Stockholder rights plan	1%	2%	0.5%	1%

*Delaware corporations only
Source: WilmerHale analysis of SEC filings from 2007 to 2016 (2011–2016 only for exclusive forum provisions) for US issuers.

One major reason is a voting policy recently adopted by Institutional Shareholder Services (ISS), the leading proxy advisory firm, which has resulted in more negative vote recommendations on directors where, prior to an IPO, the company adopts charter or bylaw provisions considered by ISS to be adverse to stockholder rights, such as a classified board or a multi-class capital structure. Under its policy, ISS considers the following factors in making its voting recommendations:

- the level of impairment of stockholder rights caused by the provision;
- the company’s or the board’s rationale for adopting the provision;
- the provision’s impact on the ability of stockholders to change the company’s governance structure in the future (such as limitations on the stockholders’ right to amend the bylaws or charter, or supermajority vote requirements to amend the bylaws or charter);
- the ability of stockholders to hold directors accountable through annual director elections, or whether the company has a classified board structure; and


- any sunset provision that will in the future result in the elimination of the disfavored provision.

Importantly, ISS will now consider making a negative vote recommendation on directors at all future stockholder meetings until the adverse provision is either removed by the board or submitted to a vote of public stockholders.

The Council of Institutional Investors (CII) has also recently stepped up its efforts to influence governance practice at IPO companies. The CII’s new policy on Investor Expectations for New Public Companies calls for companies, upon going public, to have a “one share, one vote” structure, simple majority vote requirements, independent board leadership and an annually elected board. The CII policy further provides that CII expects IPO companies without such provisions to commit to their adoption over a reasonably limited period post-IPO.

It remains to be seen whether these changing tides will lead to a major course correction not unlike what has transpired among more established public companies, but directors of newly public companies are well advised to prepare for some potentially rough seas ahead. ■

22 Best Practices: It's More Than Just Following the Rules

 The last 15 years have witnessed an explosion in SEC and stock exchange requirements relating to corporate governance and executive compensation. But complying with applicable rules is just the first step in the life of a newly public company, as institutional investors, proxy advisory firms such as ISS and Glass Lewis, and others continue to offer a seemingly endless and frequently evolving supply of recommended “best practices.”

In the last year alone, new or revised model corporate governance guidelines were published by Investor Stewardship Group, whose signatories include many leading global money management firms; Council of Institutional Investors, a nonprofit association of employee benefit plans, foundations and endowments with significant combined assets; Business Roundtable, an association of CEOs of leading US companies; and another group of prominent CEOs and representatives of investment managers and institutional investors who published a self-styled “Commonsense Corporate Governance Principles.”

Moreover, as is the case each year, the proxy advisory firms also made numerous updates to their voting policies and rating systems, and as is becoming increasingly common, a number of prominent investor groups and money management funds continued their practice of sending letters to their portfolio companies, often highlighting desired governance or disclosure practices.

While lacking the force of law, best practices cannot be ignored, as some stakeholders routinely measure public companies against lists of desirable practices. The results of these assessments can influence proxy advisory firm recommendations and stockholder voting. As a result, public company boards find themselves devoting a significant portion of their time—too much of their time, many would lament—debating the merits of recommended practices while still ensuring compliance with applicable regulatory requirements.

The litany of topics swept in by the catchall phrase “best practices” ranges from

some that are concrete and prudent to others that are aspirational or unrealistic. Nonetheless, directors who turn a deaf ear to stockholder expectations may find votes withheld in board elections, be required to include stockholder proposals in their proxy statements, or even find their actions questioned in litigation. In some cases, ignoring best practices could also result in a lost opportunity to truly improve the company's operations and oversight.

Even if some of the provisions of the Dodd-Frank Act and/or the Sarbanes-Oxley Act are rolled back, as advocated by the new US presidential administration and some members of Congress, investors and other stakeholders are unlikely to curb their efforts to push companies to do more than the minimum required by applicable rules. Indeed, in certain areas such as climate change and sustainability, any repeal or retreat by regulators might be countered by increased activity by various non-governmental organizations and charitable foundations that are focused on sustainability and social issues.

Listed below are some of the practices and policies that public companies may be urged to follow. Needless to say, circumstances vary widely, and these may or may not be appropriate for a particular company.

BOARD OF DIRECTORS

- Ensure that a substantial majority or all board members, other than the CEO, are independent.
- Separate the roles of chair and CEO, or designate a lead or presiding director if the chair and CEO are the same person.
- In uncontested elections, provide that directors are elected by majority vote rather than a plurality (i.e., require that a nominee receive more votes “for” his or her election than “against” his or her election, rather than allowing someone to be elected so long as he or she receives at least one vote under a plurality system).
- Limit to 90 or 180 days the maximum period of time that a director who did not receive a majority vote in support

of his or her re-election is permitted to continue to serve as a director.

- Provide that all directors stand for annual election rather than maintaining a classified (or staggered) board system in which only one-third of the directors stand for re-election each year.
- Arrange for orientation training and continuing education for all directors.
- Conduct annual reviews of board and committee performance (required by NYSE rules) and individual director performance and provide proxy disclosure describing the board's processes for evaluating directors.
- Develop a succession plan for the CEO and other top executives and provide proxy disclosure about the board's processes relating to succession planning.
- Develop a director succession plan.
- Establish director term limits or stop considering long-tenured directors to be independent.
- Limit the number of other directorships the CEO and other executives or directors may hold to avoid situations where a director is “over-boarded.”
- Select director nominees in accordance with qualification standards that are established and published by the board.
- Increase board diversity and provide quantitative proxy disclosure about the percentage of women and minorities serving as directors.
- Require directors to offer to tender their resignations upon job changes.
- Create stock ownership guidelines or requirements for officers and directors.
- If board vacancies are filled by board action, permit stockholders to vote on new directors at the next annual meeting.
- Establish a process that provides stockholders a meaningful opportunity to suggest candidates for director nominations or otherwise communicate with the board.

- Allow stockholders to include the names of nominees for election in the proxy statement that is prepared by the company (generally referred to as “proxy access” which, in its most common form, allows a group of up to 20 stockholders who have collectively held at least 3% of a company’s voting stock for at least three years to nominate up to 20% of the total number of directors).
- Publicly disclose policies and procedures for direct engagement between directors and stockholders.
- Create a stockholder relations committee of the board.

BOARD COMMITTEES

- Ensure that a majority or all members of the audit committee qualify as “Audit Committee Financial Experts” under SEC rules.
- Prohibit current or former CEOs of public companies from serving on the compensation committee.
- Establish a separate nominating/governance committee consisting solely of independent directors (required by NYSE rules).

EXECUTIVE COMPENSATION

- Require directors and executives to retain equity awards for a specified minimum period of time following vesting or through retirement.
- Grant performance-based equity awards (rather than time-based awards).
- For time-based equity awards, require a minimum vesting period.
- Prohibit or limit the acceleration of vesting of equity awards.
- Establish standards for Rule 10b5-1 trading plans adopted by insiders, such as minimum waiting periods before transactions under the plan commence, public disclosure requirements, and limitations on when plans may be entered into.

- Adopt a policy for the recoupment (or “clawback”) of incentive compensation that was determined on the basis on financial statements that are later restated.
- Avoid employment contracts with executives, especially contracts with multi-year guarantees.
- Avoid excessive pay differentials between the CEO and the other executive officers and between the CEO and the median employee.
- Do not use the same performance metrics for both short-term and long-term incentive programs.
- Avoid large bonus payouts without justifiable performance linkage or disclosure.
- Do not change performance metrics during a performance period.
- In annual proxy statement, explain how the company’s compensation programs support achievement of the company’s long-term strategy.
- Avoid excessive perks and do not provide for tax gross-ups for perks.
- Prohibit directors and officers from pledging or hedging company stock.
- Avoid single-trigger change-in-control provisions.
- Exclude the impact of stock repurchases from determinations of achievement of compensation performance targets.
- Do not provide for tax gross-ups for severance payments.
- Require stockholder approval of severance arrangements.
- Require stockholder approval for executive death benefits.

STOCKHOLDER RIGHTS

- Do not adopt a poison pill without stockholder approval.
- Provide that a majority vote of stockholders may amend the corporate charter or bylaws and approve mergers.

- Permit stockholders to act by written consent.
- Allow stockholders holding at least 10% of the company’s shares to call special meetings.
- Do not utilize a multi-class capital structure with disparate voting or economic rights.
- Do not authorize blank check preferred stock.

OTHER GOVERNANCE MATTERS

- Establish corporate governance guidelines (required by NYSE rules).
- Adopt a related person transaction policy.
- Adopt an insider trading policy.
- Adopt a disclosure policy.
- Establish a disclosure committee.
- Post corporate governance documents on corporate website (required by NYSE rules).
- Adopt simple majority voting (providing that a proposal is passed only if the votes for the proposal exceed the votes against the proposal, without taking into consideration abstentions or broker non-votes) for all matters on which stockholders vote.

CORPORATE SOCIAL RESPONSIBILITY

- Publish a comprehensive sustainability report addressing how the company’s operations affect the environment and society.
- Integrate disclosure about sustainability issues into the company’s SEC filings.
- Make public disclosure about the company’s carbon footprint and other impacts of climate change.
- Adopt a policy regarding public disclosure of political contributions and lobbying activity.
- Adopt and disclose a broad equal employment opportunity and non-discrimination policy.
- Adopt international fair labor and human rights standards.
- Address income inequality issues, including gender pay gaps and the minimum wage. ■

While most companies go public with a single class of common stock that provides the same voting and economic rights to every stockholder (a “one share, one vote” model), an increasing number of companies are going public with a multi-class capital structure under which some or all pre-IPO stockholders hold shares of common stock that are entitled to multiple votes per share, while the public is issued a separate class of common stock that is entitled to only one vote per share, or in one very recent example, no general voting rights.

PURPOSE AND EFFECT

Use of a multi-class capital structure enables the holders of the high-vote class of common stock to retain voting control over the company, even while selling a large number of shares of stock to the public. Supporters of this technique believe that it can enable company founders to pursue strategies to maximize long-term stockholder value rather than seeking to satisfy the quarter-to-quarter expectations of short-term investors. Critics, however, believe that a multi-class capital structure entrenches the holders of the high-vote stock, insulating them from takeover attempts and the will of the public stockholders, and that the mismatch between voting power and economic interest may increase the possibility that the holders of the high-vote stock will pursue a riskier business strategy.

A multi-class capital structure can also be employed to provide different classes of stock with equivalent voting rights but disparate economic rights, such as the right to receive dividends or distributions upon liquidation, or can be utilized for tax structuring reasons.

TIMING OF IMPLEMENTATION

If a multi-class capital structure is going to be implemented, it must be put in place prior to the company’s IPO, as both Nasdaq and NYSE restrict the ability of already public companies to implement multi-class capital structures.

A company may implement a multi-class capital structure either upon incorporation

or at some later point prior to its IPO. Due to fiduciary duty limitations, if a multi-class capital structure is implemented after incorporation, all then-existing stockholders will hold high-vote stock unless they otherwise agree, and thereafter the company can issue any class of authorized stock (high-vote, low-vote or no-vote) to subsequent stockholders. If a company implements a multi-class capital structure upon incorporation, it can elect to issue stock of any authorized class from the outset.

PREVALENCE

Multi-class capital structures are not new, but they are appearing with greater frequency and, in some instances, have greater disparity in voting power among classes than historically seen. As recently as 2008, no company went public with a multi-class capital structure, but since then almost 10% of all US companies completing IPOs have had a multi-class capital structure.

In addition, at least four public companies that employed a dual-class capital structure for their IPOs over the past 15 years subsequently authorized a third class of non-voting stock for potential use for stock-based acquisitions and equity-based employee compensation without dilution of the founders’ voting control. For each of these four companies, the post-IPO creation of non-voting stock resulted in stockholder litigation alleging breaches of fiduciary duty, suggesting that an IPO company that desires to have non-voting stock available for use after its IPO should consider building the non-voting stock into its capital structure prior to the IPO. In early March, Snap became the first company to do so, by offering non-voting shares to the public.

STRUCTURE

The most common approach to a multi-class capital structure in recent years has consisted of:

- Class A common stock, with one vote per share, sold to the public; and

- Class B common stock, with 10 votes per share, held by all pre-IPO stockholders (generally the result if the structure is implemented shortly before the IPO) or held only by the founders and other selected pre-IPO stockholders (generally indicating that the structure was implemented upon incorporation or early in the company’s life).

In most multi-class capital structures the disparate voting rights apply to all voting matters, except as otherwise required by applicable state corporate law, but the higher voting rights of the high-vote stock are sometimes limited to specific matters.

MARKET PRACTICES

Implementation of a multi-class capital structure requires decisions to be made on a number of structural questions. To assess market practices, we reviewed the SEC filings of all VC-backed tech companies with multi-class capital structures that completed IPOs from 2007 to 2016. There were a total of 30 companies in the sample, representing approximately 10% of all US IPOs in this period. Below is a summary of our findings:

Number of Classes

- At the time of IPO:
 - 29 of the 30 companies had two classes of stock (two of these companies subsequently created a third class of non-voting stock).
 - One company had three classes of stock (high-vote, super-high-vote and low-vote).

Voting Rights

- Of the 30 companies, 27 provided that the high-vote stock had 10 votes per share:
 - In 25 companies, the high-vote stock had 10 votes per share on all matters.
 - In one company, the high-vote stock had 10 votes per share on changes of control and charter amendments and one vote per share on all other matters.
 - In one company, the high-vote stock had 10 votes per share on changes of control or certain changes to equity incentive plans and one vote per share on all other matters.

- One company provided that the high-vote stock had 150 votes per share.
- One company provided that the high-vote stock had 20 votes per share.
- One company provided that one class of high-vote stock had 70 votes per share on all matters and the other class of high-vote stock had seven votes per share.

Holders of High-Vote Stock

- In 22 of the 30 companies, the high-vote stock was held by all pre-IPO stockholders.
- In two companies, the high-vote stock was held by founders and certain other pre-IPO stockholders.
- In four companies, the high-vote stock was held by founders only.
- In two companies, the high-vote stock was held by certain pre-IPO stockholders other than founders.

Stock Incentive Plans

- In 23 of the 30 companies, the high-vote stock was used for pre-IPO awards and the low-vote stock was used for post-IPO awards.
- In seven companies, the low-vote stock was used for all awards.

Preferred Stock Conversion

- In 23 of the 30 companies, preferred stock converted into high-vote stock in the IPO.
- In three companies, preferred stock converted into low-vote stock in the IPO.
- In two companies, one or more series of preferred stock converted into high-vote stock in the IPO and one or more series of preferred stock converted into low-vote stock in the IPO.
- Two companies had no outstanding preferred stock at the time of the IPO.

Mandatory Conversion Events for High-Vote Stock

- Any transfer (with specified exceptions)—all 30 companies.
- Death or incapacity/disability of holder (sometimes with founder exception or delay)—20 companies.
- Class vote by high-vote holders—21 companies (2/3 vote in 12 companies, and majority vote in nine companies).

- Sunset provision—14 companies (11 companies with 5-10 years, one company with 12 years, one company with 17 years and one company with 20 years).
- Treatment of partnership distributions:
 - In five companies, there are specific exceptions for transfers of high-vote stock from partnerships to partners and from limited liability companies to members.
 - In the other 26 companies, it appears the high-vote stock converts into low-vote stock upon a limited partnership's distribution to its limited partners.
- Dilution tests:
 - In 12 companies, the high-vote stock converts to low-vote stock when the high-vote stock represents less than a specified percentage (ranging from 5% to 25%) of all outstanding common stock.
 - In two companies, the high-vote stock converts to low-vote stock when the high-vote stock represents less than a specified percentage (5% and 10%, respectively) of the voting power of all outstanding capital stock.
 - In one company, the high-vote stock converts to low-vote stock when the high-vote stock represents less than 20% of the shares of high-vote stock outstanding at the time of the IPO.
 - In one company, the high-vote stock converts to low-vote stock when less than a specified number of shares of high-vote stock (which represented 10.2% of the outstanding shares of high-vote stock plus low-vote stock at the time of the IPO) are outstanding.

CONCLUSION


Although disfavored by institutional investors and proxy advisory firms, a multi-class capital structure can serve legitimate purposes and further stockholder interests. The board of a company considering the implementation of a multi-class capital structure needs to balance its intended benefits against the risks of entrenchment (particularly if the specific structure chosen favors the founders or another small group of stockholders) and the potential for adverse investor sentiment. ■

THE SAMPLE SET

For our review of market practices, we reviewed the multi-class capital structures in the following IPOs:

- AppFolio (2015)
- Apptio (2016)
- Box (2015)
- Castlight Health (2014)
- Clearwire (2007)
- Facebook (2012)*
- Fitbit (2015)
- GoPro (2014)
- Groupon (2011)
- Internet Brands (2007)
- KAYAK Software (2012)
- KiOR (2011)
- LinkedIn (2011)
- MaxLinear (2010)
- MINDBODY (2015)
- Nutanix (2016)
- Pure Storage (2015)
- RingCentral (2013)
- Square (2015)
- Tableau Software (2013)
- The Trade Desk (2016)
- Twilio (2016)
- Veeva Systems (2013)
- Wayfair (2014)
- Workday (2012)
- Workiva (2014)
- Yelp (2012)
- Zillow (2011)*
- zulily (2013)
- Zynga (2011)

**subsequently authorized a class of non-voting common stock*

 Startup companies routinely rely on exemptions from the registration requirements of the Securities Act to complete private placements of securities. Over the past few years, the pre-IPO financing toolkit has been significantly expanded.

As a result of the JOBS Act, the principal exemption historically relied upon (Regulation D) now permits general solicitation and advertising in selected offerings. The JOBS Act also created two other exemptions—one primarily directed to early-stage companies (crowdfunding) and one of greater appeal to later stage companies (an expanded Regulation A). The Regulation D, crowdfunding and Regulation A exemptions are available to all eligible companies, whether or not they qualify as emerging growth companies under the JOBS Act, but are not available to “bad actors” under SEC rules or specified types of non-operating companies. In addition, following enactment of the JOBS Act, the SEC adopted amendments to Rule 147 and a new companion Rule 147A, both of which became effective on April 20, 2017, for intrastate securities offerings.

REGULATION D

Regulation D, which has existed for more than 30 years, is available to both US and foreign companies, whether privately or publicly held. Regulation D consists of separate rules, the application of which may vary depending on the size and nature of the offering. Rule 506 under Regulation D is generally considered the most flexible and useful of these rules because it does not limit size, investment amount or the number of accredited investors, and does not impose specific disclosure requirements (unless the offering includes unaccredited investors). “Accredited investors” are high-income or high-net-worth individuals, entities satisfying specified standards, and certain other investors.

Until the enactment of the JOBS Act, Regulation D prohibited general solicitation and advertising in connection with private placements conducted pursuant to Regulation D. The JOBS Act required the SEC to eliminate this prohibition in certain private placements under Rule 506.

Effective September 23, 2013, the SEC adopted new paragraph (c) to Rule 506 to permit general solicitation and advertising in Rule 506 (c) private placements if the company takes reasonable steps to verify that all purchasers are accredited investors; each purchaser is (or the company reasonably believes that each purchaser is) an accredited investor; and all other applicable terms and conditions of Regulation D are satisfied. Pre-existing Rule 506(b) remains available for offerings conducted without general solicitation or advertising. Although, to date, Rule 506(c) has been used far less frequently than Rule 506(b), the popularity of offerings involving general solicitation or advertising under Rule 506(c) is likely to grow as companies become more familiar and comfortable with Rule 506(c).

REGULATION CROWDFUNDING

In a “crowdfunding” financing, a company uses the Internet to seek small investments from a large number of investors. Such transactions must be registered or qualify for an exemption if they involve the offer and/or sale of securities. The JOBS Act created a new exemption that permits private US companies, without Securities Act registration, to publicly offer and sell securities in crowdfunding transactions raising up to \$1.07 million within any 12-month period. The SEC’s rules implementing this provision of the JOBS Act (referred to as “Regulation Crowdfunding”) became effective on May 16, 2016 and provide that:

- **Eligibility:** Crowdfunding is available to US companies that are not Exchange Act reporting companies.
- **Maximum Offering Size:** Within any 12-month period, the maximum offering size for crowdfunding transactions is \$1.07 million.
- **Investor Limits:** The maximum amount an investor may invest in any crowdfunded offerings in a 12-month period is equal to:
 - the greater of \$2,200 or 5% of the annual income or net worth of the investor, if both the annual income and net worth of the investor are less than \$107,000; or

- 10% of the annual income or net worth of the investor, not to exceed a maximum aggregate investment of \$107,000 by the investor, if either the annual income or net worth of the investor is equal to or more than \$107,000.

For a natural person, annual income and net worth may be calculated jointly with the annual income and net worth of the person’s spouse.

- **Mandatory Use of Intermediary:** An intermediary—either a registered broker-dealer or a “funding portal”—must be used to effect crowdfunding transactions through an Internet website. The intermediary must register with the SEC, assure that investment limits are not exceeded and satisfy other requirements.
- **Disclosure Requirements:** The company must file with the SEC, and provide to investors and the intermediary, an offering statement on Form C that includes specified information regarding the company and its management, the offering, and the intermediary’s financial interests in the company and the offering. The Form C must also include, for the company’s two most recent fiscal years, financial statements that have been:
 - certified by the company’s CEO, for offerings of \$107,000 or less;
 - reviewed (but not audited) by an independent public accountant, for offerings of more than \$107,000 but not more than \$535,000; and
 - reviewed (but not audited) by an independent public accountant, for offerings of more than \$535,000 (except that the financial statements must be audited if the offering is not the company’s first crowdfunded offering).
- **Updates and Progress Reports:** The company must update its Form C to disclose material changes; must disclose (in SEC filings or on the intermediary’s platform) its progress in meeting the target offering amount; and, within five business days after the offering, must file a Form C-U with the SEC to report the total offering proceeds.
- **Offering Timeline:** Offerings must be held open for at least 21 days and potential investors can cancel an investment commitment until 48 hours prior to the offering deadline.

- **Investor Solicitation:** The company may communicate with investors about itself and the offering through the intermediary's platform. Advertisements must be limited to a statement that the company is conducting an offering, the name of the intermediary through which the offering is being conducted and a link to its platform, the terms of the offering, contact information for the company, and a brief description of the company's business. Promoters must disclose the receipt of compensation in each communication.
- **Reporting Obligations:** Following completion of a crowdfunding transaction, the company must, within 120 days after the end of each fiscal year, post on its website and file with the SEC an annual report updating much of the Form C information. This reporting obligation generally lasts until the company registers as a reporting company under the Exchange Act.
- **Resale Limitations:** Investors may not resell securities purchased in crowdfunding transactions for one year except to the company, to an accredited investor, to family members, in connection with death or divorce, or in an SEC registered offering.

As required by the JOBS Act, the dollar thresholds specified above reflect inflation adjustments that became effective in April 2017.

REGULATION A+

In addition to creating the crowdfunding exemption, the JOBS Act sought to revitalize Regulation A, which has existed since the dawn of federal securities law. Regulation A provides an exemption from registration for small public offerings but was seldom used in recent years, partly due to the \$5 million maximum offering size. To address the perceived limitations in Regulation A, the JOBS Act effectively created a new exemption dubbed "Regulation A+."

In March 2015, the SEC adopted rules creating two tiers of Regulation A+ offerings, with different offering caps, disclosure requirements and ongoing reporting obligations:

- Tier 1 offerings may raise up to \$20 million, including no more than \$6 million offered by selling stockholders, in a 12-month period; and
- Tier 2 offerings may raise up to \$50 million, including no more than \$15 million offered by selling stockholders, in a 12-month period.

For offerings up to \$20 million, the company may elect to proceed under either tier.

Provisions Applicable to Both Tier 1 and Tier 2 Offerings

- **Eligibility:** Regulation A+ is available to non-reporting US and Canadian companies.
- **Disclosure Requirements:** Offerings are made pursuant to an offering statement that includes basic information about the company, its management and the offering. It also must include balance sheets as of the company's two most recent fiscal year-ends and other financial statements not older than nine months.
- **SEC Filing and Review:** Offering statements must be filed with the SEC (on Form 1-A) and are subject to SEC review. Companies may submit draft offering statements for nonpublic SEC review prior to filing.
- **Resales:** Securities sold pursuant to Regulation A+ are freely transferable, except by affiliates of the company.
- **Investor Solicitation:** The company may solicit investor interest using written "testing-the-waters" materials filed with the SEC.

Provisions Applicable Only to Tier 2 Offerings

- **Investor Limits:** Investors that do not qualify as accredited investors are limited to purchasing no more than 10% of the greater of the investor's annual income or net worth (for an entity, the limit is 10% of the greater of the entity's annual revenue or net assets at fiscal year-end).
- **Financial Statements:** The financial statements included in the offering statement and annual reports must be audited.

- **Periodic Reporting Requirements:** The company is required to file annual reports, semi-annual reports and current event reports with the SEC that are similar to the requirements for public company reporting under the Exchange Act.

RULES 147 AND 147A

In October 2016, the SEC adopted amendments to Rule 147 and a new companion Rule 147A, effective April 20, 2017, in an effort to modernize and expand the federal exemptions for intrastate securities offerings, including intrastate crowdfunding transactions. The amendments to Rule 147 include new and revised residency and "doing business" requirements and an integration safe harbor. Rule 147A is substantively identical to Rule 147, but allows unlimited offers (but no sales) outside the applicable state, and also allows the company to be incorporated or organized outside the applicable state so long as the company can demonstrate the "in-state" nature of its business. Offerings under both rules must comply with applicable state blue sky laws.

PRACTICAL TAKEAWAYS

Due to the disclosure, financial statement and ongoing reporting requirements of the crowdfunding exemption, its practical utility may be limited, particularly for pre-IPO companies whose capital needs significantly exceed the \$1.07 million maximum. Although the maximum size of a Regulation A+ offering has been substantially increased, an offering under Tier 2 imposes limits on the amount of securities that may be sold to unaccredited investors and requires audited financial statements and ongoing public reporting. Amended Rule 147 and new Rule 147A, will likely be of limited interest other than to local companies whose fundraising can be confined to in-state residents. As a result of these limitations, pre-IPO companies may find that the use of Regulation D—either under Rule 506(c) permitting general solicitation but limited to accredited investors, or under good old Rule 506(b) prohibiting general solicitation but not limited to accredited investors—has more appeal than the new exemptions. ■

 An IPO is a major milestone for any company, but the offering proceeds only last so long. Several post-IPO financing alternatives, together with potential challenges they can pose, are discussed below.

FOLLOW-ON PUBLIC OFFERINGS

A public offering of securities after an IPO—termed a follow-on public offering—can be used to raise additional equity or debt capital. Depending on how long the company has been filing periodic reports with the SEC, the size of its public float and other considerations, follow-on public offerings are conducted either on the same type of registration statement used for the IPO (Form S-1) or an abbreviated form of registration statement (Form S-3) that is available if certain requirements are met.

Form S-1: Unless the company is eligible to use Form S-3, a follow-on public offering must be registered on Form S-1. The disclosure requirements for a follow-on public offering of common stock on Form S-1 are substantially the same as for an IPO (a debt offering has additional disclosure requirements). In some circumstances, a public company may incorporate by reference information from its prior Exchange Act filings into a Form S-1. If qualifying as a “smaller reporting company” under SEC rules (generally, a company with a public float of less than \$75 million), a company may also incorporate by reference information from its future Exchange Act filings, rather than amend the Form S-1 to add that information.

Form S-3: Use of Form S-3 can provide significant time and transaction cost savings by permitting the company to incorporate by reference information from the company’s prior Exchange Act filings, rather than repeat that information in the Form S-3, and to incorporate by reference information from its future Exchange Act filings, rather than amend the Form S-3 to add that information.

Shelf Offerings: If the company is eligible to use Form S-3, it can conduct primary “shelf” offerings pursuant to Rule 415 under the Securities Act. In a shelf offering, the Form S-3 is filed, undergoes SEC review (if any) and is declared effective in advance of any specific offering. During

the ensuing three years, the company can offer equity or debt securities pursuant to a prospectus supplement that describes the specific offering terms and is filed with the SEC within two business days after pricing—without further SEC action. The company may file another shelf Form S-3 when all securities covered by the Form S-3 have been sold or the three-year time limit is reached. Subject to market conditions, Rule 415 provides eligible companies with the ability to access the public capital markets on short notice as company needs dictate and market conditions permit.

WKSI Shelf Offerings: A special category of public company called a “well-known seasoned issuer” (generally, a Form S-3–eligible company with a public float of at least \$700 million) enjoys even more flexibility. A WKSI may file a shelf registration statement on Form S-3 that becomes automatically effective, completely bypassing SEC review of the registration statement, and use prospectus supplements to offer and sell securities under the Form S-3 for a period of up to three years. As a result, a WKSI can make registered public offerings of equity or debt securities at will and reap the maximum time-to-market advantage.

At-the-Market Offerings: In an at-the-market (ATM) offering, the company sells securities (typically common stock) from an effective shelf registration statement at the prevailing market price rather than negotiating a fixed price with investors. The shares are sold directly by the company or through a placement agent. Upon establishing the arrangements for an ATM offering, the company files a prospectus supplement describing the offering; completed sales are either disclosed in subsequent Form 10-Qs and Form 10-Ks or announced sooner, if material. For larger companies with substantial public floats that can absorb additional shares, ATM offerings can provide undiscounted access to the capital markets, alone or in conjunction with other financing sources.

Hybrid Public-Private Offerings: In a registered direct offering (RDO) or a confidentially marketed public offering (CMPO), company securities (typically common stock) that are subject to an effective shelf registration statement are confidentially marketed for several

days to a targeted group of institutional investors. An RDO is announced after the company reaches agreement on the offering terms with investors, and a prospectus supplement describing the offering terms is then filed with the SEC. A CMPO is opened to public investors after confidential marketing; the company issues a press release to announce the offering, immediately distributes a preliminary prospectus supplement to prospective investors, and then files the preliminary prospectus supplement with the SEC. Before the market opens on the next trading day, the CMPO is priced, the final prospectus supplement is distributed to investors, and both documents are filed with the SEC. Shares issued in an RDO or CMPO are sold at a discount from the market price.

RULE 144A PLACEMENTS

In a Rule 144A placement, the company issues securities (typically debt or convertible debt) to an initial purchaser in a private placement that is exempt from registration pursuant to Section 4(a)(2) of the Securities Act. The initial purchaser, which is usually an investment banking firm, then resells the securities to qualified institutional buyers (QIBs) under Rule 144A or in offshore transactions under Regulation S. The initial purchaser’s resales are made pursuant to an offering memorandum or circular; the level of disclosure will depend on the nature of the company, offering and targeted investors. Rule 144A marketing practices vary, but often include a short road show or other investor meetings. The principal advantage of a Rule 144A placement over a registered follow-on public offering is that it enables a company to get to market quickly, without the risk of delays from SEC review of a registration statement.

PIPE FINANCINGS

PIPE (private investment in public equity) financings are private placements conducted by public companies pursuant to exemptions from registration, typically Section 4(a)(2) or Regulation D. A PIPE offering is typically marketed through an investment banking firm, acting as a placement agent. The placement agent conducts due diligence, structures the

offering and solicits interest from potential investors (often employing a private placement memorandum). Investors sign financing agreements with the company, the company issues the PIPE securities (typically common stock or preferred stock) to the investors at a discount from the market price, and the placement agent collects a percentage fee from the company at closing. PIPE transactions are particularly favored by small-cap and mid-cap companies with substantial capital needs but limited access to the Rule 144A market.

ADDITIONAL CONSIDERATIONS

Stockholder Approval: In general, companies listed on Nasdaq or the NYSE can issue shares for cash in public offerings without any requirement for stockholder approval under stock exchange rules. Listed companies must, however, obtain stockholder approval for any private issuance of securities representing or convertible into 20% or more of their pre-financing outstanding shares or voting power if the purchase price is below the book value or market price per share. Under exchange rules:

- Rule 144A placements and PIPE financings are not public offerings, and a typical RDO also will not qualify as a public offering for purposes of the stockholder approval rules.
- A CMPO that is broadly marketed to the public may qualify as a public offering. Nasdaq specifies the criteria that must be satisfied in order for a CMPO to qualify as a public offering, but the NYSE has not provided formal guidance on the question.

As a result, the issuance of securities representing or convertible into 20% or more of a listed company's pre-financing outstanding shares or voting power in a Rule 144A placement, PIPE financing or RDO—or in a CMPO that is not marketed sufficiently broadly to qualify as a public offering—at a discount from the book value or market price will require stockholder approval before issuance.

Regulation FD: Regulation FD prohibits a public company from intentionally disclosing material nonpublic information to securities market professionals and securityholders unless the company simultaneously publicly discloses the

information. In general, Regulation FD applies as follows to a public company's financing transactions:

- Regulation FD *does not* apply to written and oral statements in connection with registered follow-on public offerings, including primary shelf offerings, RDOs, CMPOs and ATM offerings (it does apply to resale shelf offerings).
- Regulation FD *does* apply to written and oral statements made in connection with a Rule 144A placement or PIPE financing.

When Regulation FD applies, the company should announce the proposed financing before it is disclosed to potential investors, unless all offerees sign a confidentiality agreement. In addition, the company must avoid disclosing material nonpublic information during investor meetings or in written offering materials, unless the recipients agree to keep the information confidential or the company publicly discloses such information prior to or simultaneously with such disclosure. In transactions in which Regulation FD does not apply, the company should consider whether it is sound investor relations practice to disclose to investors material information that it does not disclose to the market generally.

Other Disclosure Issues: Follow-on offerings can create challenging public disclosure issues. For example:

- *Adequacy of existing public disclosure:* Most RDOs and CMPOs are conducted without specific risk factors or updating the company's existing Exchange Act disclosures. Although this approach is permitted by the shelf registration rules and enables RDOs and CMPOs to be completed very quickly, offering participants need to be comfortable that appropriate disclosure is made to investors.
- *Announcement of abandoned offering:* The company may be required to announce that it has abandoned a proposed offering, either because confidentiality agreements signed by the company and private offerees mandate public disclosure if the proposed offering is not completed by a specified date (in order to permit the offerees to resume trading in the company's securities) or because the company concludes that knowledge of the abandoned offering

CAN WE USE FORM S-3?

In order to use Form S-3, a public company must satisfy both *company* requirements and *transaction* requirements.

In general, Form S-3 is available to any US company that:

- has been subject to the Exchange Act for at least 12 calendar months and has timely filed all required reports during the 12 calendar months and any portion of a month immediately preceding the filing of the Form S-3; and
- has not, since the end of its last fiscal year, failed to pay any dividend or sinking fund preferred stock obligation or defaulted on any material indebtedness for borrowed money or long-term lease obligation.

Transaction requirements vary by type of security and offering. For example, if the company has a public float of at least \$75 million, it can use Form S-3 for a primary offering of equity or debt securities of any size; if the company's public float is less than \$75 million, it can use Form S-3 to register equity or debt securities, over any period of 12 calendar months, with an aggregate market value of up to one-third of the company's public float. Other eligibility rules also apply to non-convertible debt, rights offerings, dividend reinvestment plans, and outstanding convertible securities, options and warrants.

constitutes material information that the company must publicly disclose.

FINRA Clearance: With few exceptions, FINRA rules prohibit underwriters and broker-dealers from participating in a public offering unless FINRA determines that the underwriting compensation and other terms are "fair and reasonable." In an IPO, this determination often requires several months to reach. FINRA rules exempt from filing certain types of offerings, most notably shelf offerings registered on Form S-3 based on old eligibility standards that are significantly more stringent than the current Form S-3 standards and cannot be satisfied until the company has been public at least three years. FINRA also offers a same-day clearance process for non-WKSI shelf offerings and an immediate clearance process for WKSI shelf offerings. ■

■ ■ ■ Is your company torn between an IPO and a sale? Is your company qualified and willing to take on an IPO, yet enticed by the prospect of selling, and unsure how to compare the relative ease and certainty of being acquired with the attraction of the equity upside of an IPO? Is your company concerned about the uncertainty of both an IPO and a sale, making it prudent to pursue both options to increase the odds of one being successful?

If you respond affirmatively to any of these questions, the optimal route to liquidity may be a “dual track.”

In a dual-track process, a company simultaneously pursues an IPO while entertaining—or even courting—acquisition offers. The company’s sale efforts on a dual track can range from contacting a small number of likely buyers to a more formal and extensive process similar to an auction. Even if a company does not deliberately embark upon a dual track, an IPO filing can have a similar effect, by showcasing the company and enticing potential buyers to inquire about acquisition interest. In that sense, every IPO is on a dual track.

In addition to preserving flexibility when a company is uncertain whether to pursue an IPO or sale, a dual track can serve as a strategy to maximize the price received when a sale is preferred to, or more likely than, an IPO. The core of this approach is to increase the sense of urgency among bidders—“buy now, or the target will soon become a public company and much more expensive”—as well as to emphasize to bidders that the target has a compelling alternative to being acquired. Needless to say, an IPO must be viable, in terms of the company’s attributes and market conditions, for this strategy to work. The stronger the IPO market and the more attractive the company, the more likely a dual-track strategy will pay off. If the company has filed the Form S-1, has cleared SEC comments, and is poised to commence the road show, even better—although the company must consider whether public disclosure of the estimated offering range will adversely affect price negotiations with bidders.

CHALLENGES AND IMPLICATIONS

In addition to the considerations that are present in the sale of any private company, a dual-track strategy presents various challenges that must be navigated carefully:

- *Importance of Confidentiality:* Even more so than usual, the M&A process must be kept under wraps, to minimize the risk of premature disclosure and to avoid disruption to the effort and focus demanded by the IPO process.
- *Disclosure Issues:* Absent a leak, the sale process usually need not be publicly disclosed prior to an acquisition announcement. A dual-track strategy can, however, result in two thorny disclosure issues if the company opts for an IPO rather than a sale. One, if an acquisition deal is reached and then falls apart, the company must consider whether the reasons for the busted deal must be disclosed in the IPO prospectus. This could prompt negative disclosures and delay an IPO while the prospectus is supplemented. Two, if the company passes on a sale opportunity and then is acquired shortly after the IPO, it will be vulnerable to claims that it failed to disclose its intention to be acquired. The practical exposure, however, is limited if the post-IPO acquisition price is at a premium to the IPO offering price.
- *Selection of Legal Advisors:* The company will almost certainly utilize its IPO law firm for the M&A track—to use different counsel for the two tracks would squander the hard-earned institutional knowledge from the IPO process and create logistical and other challenges—but should make sure appropriate M&A expertise is available on the company counsel team for the potential sale.
- *Selection of Financial Advisors:* The company will ordinarily want financial advisors to handle the sale side of the dual track. The IPO managing underwriters will know the company best and be obvious choices for the M&A engagement, but may be more skilled as underwriters than as M&A advisors. Or, one of the managing underwriters may be preferred to the others, leading to the potential for turf battles since the spurned underwriters will suffer the loss of the IPO fees as well as the fees (and prestige) of the M&A transaction. To manage the sale process, the company can even select an M&A advisor that is not involved with the IPO, although this approach introduces additional complications.
- *Potential for Conflicted Motivations:* The company’s management and key employees may have financial incentives to prefer one alternative over the other. A company sale often results in the replacement of top management, but may also trigger equity acceleration and change-in-control and severance payments. At the same time, an IPO offers management continued employment and the potential for market appreciation, but without the immediate realization of change-in-control benefits. Also, the economic outcomes may be different for financial advisors in a sale transaction than for underwriters in an IPO—especially if there are fewer M&A advisors than IPO underwriters to share the fees—which may give the financial advisors an incentive to steer the process one way or the other. The company’s board of directors needs to be conscious of the hazards posed by skewed incentives, and may need to make adjustments in compensation arrangements to achieve the best outcome for stockholders.
- *Board Duties:* The board’s fiduciary duties to stockholders obviously apply when considering the choice of an IPO or company sale, and when evaluating acquisition offers. Do its fiduciary duties compel a board to accept an offer that is within, or perhaps in excess of, the estimated IPO price range? No, but the board should follow an appropriate process in a dual track, as it would in any sale process.
- *Valuation Impact:* A dual track can create tricky valuation issues for the company. If the company pursues an IPO after receiving one or more acquisition offers, it must consider the impact of these offers on its subsequent determinations of fair market value for option grants made prior to the IPO. Similarly, the company needs to evaluate whether the amount of any acquisition offers should—or must—be disclosed in response to cheap stock comments from the SEC. Acquisition offers may also cause the company to revisit the operating model it uses to develop financial forecasts, or

may otherwise have an impact on the IPO valuation established by the company and managing underwriters. An offer that does not result in a completed transaction is not conclusive evidence of value, but it is not likely to be meaningless. The weight accorded to an acquisition offer will depend on various factors, such as the other terms and conditions of the offer, how advanced the proposed transaction was before its abandonment, the extent of the information made available to the bidder before it made its offer, the formality of the offer, and changes in market conditions or the company's circumstances since the offer was received.

- *Timing Considerations:* Although a company can pursue both sides of a dual-track strategy for a long time, eventually it must select one alternative. In theory, the day of reckoning can be delayed until after the IPO road show and moments before inking the underwriting agreement. In reality, the choice is usually made before going on the road, because a road show is expensive and time-consuming, and underwriters are leery of irritating fund managers with meaningless company presentations. If an attractive acquisition offer does not seem imminent, the sale process is ordinarily shut down when the road show begins.
- *Contractual Arrangements with Bidders:* The company should, of course, sign confidentiality agreements with every potential acquirer before substantive discussions or due diligence begin. Pre-existing confidentiality agreements entered into for commercial relationships almost certainly will be inadequate for this purpose. Confidentiality agreements with potential acquirers should include “standstill” provisions, pursuant to which bidders agree for a specified period of time (typically 12–24 months) not to seek or participate in any efforts to acquire the company without its consent. Potential acquirers should also commit not to solicit or hire any of the company's employees—often limited to the company employees involved with the proposed transaction—for a specified period of time (which may be equivalent to or shorter than the standstill period). Although a private company ordinarily would not need the protection of a standstill agreement when entering into acquisition discussions, if

a company on a dual track completes an IPO, it subsequently may be vulnerable to unsolicited takeover bids from parties who were given access to material non-public information about the company during the pre-IPO sale process. The standstill provisions also have the desirable effect of signaling the seriousness with which the company views its IPO alternative.

- *Sale Terms:* If an acceptable acquisition offer emerges from a dual-track process, the focus will shift to a traditional M&A negotiation, but with two wrinkles. One, there will be a strong desire to sign a definitive agreement quickly, so that the company does not miss its IPO opportunity in the event the sale cannot be concluded. Two, the company may seek to style the definitive agreement as if the transaction were a “public-public” merger, with no representations, indemnities or escrows following the closing, on the theory that its Form S-1 and IPO preparations make the target akin to a public company and justify the kind of sale terms that typically apply to the acquisition of a public company. This position has a greater likelihood of prevailing if the company is close to launching its IPO and can provide public company-type “Rule 10b-5” representations with respect to the accuracy and completeness of its Form S-1.
- *EGC Considerations:* Under the JOBS Act, an emerging growth company (EGC) can elect to submit a draft Form S-1 for confidential SEC review, but must publicly file the Form S-1 on the SEC's EDGAR system no later than 15 days before the commencement of the road show. One consequence of confidential submission is that the company is not fully showcased to potential acquirers until the subsequent public filing is made. An EGC may announce the confidential submission of a draft Form S-1 in reliance on Rule 135, but the information permitted in the announcement is very limited. As a result, an EGC that wishes to maximize its dual-track visibility may want to opt for public filing rather than confidential submission of its initial Form S-1.
- *Unwinding the IPO:* Assuming an acquisition agreement is signed after the Form S-1 has been filed with the SEC, the Form S-1 needs to be withdrawn

prior to closing the sale. Since a deal can come undone for many reasons, it is usually advisable to keep the Form S-1 and exchange listing application alive until shortly before the closing. Company counsel should, however, alert the SEC examiner and exchange listing representative to the company's plans. Similar considerations apply when an EGC that has confidentially submitted a Form S-1 is being acquired. Following the closing, the buyer will probably want to undo some of the public company infrastructure that the target had established in anticipation of its IPO, such as governance policies or new stock plans.

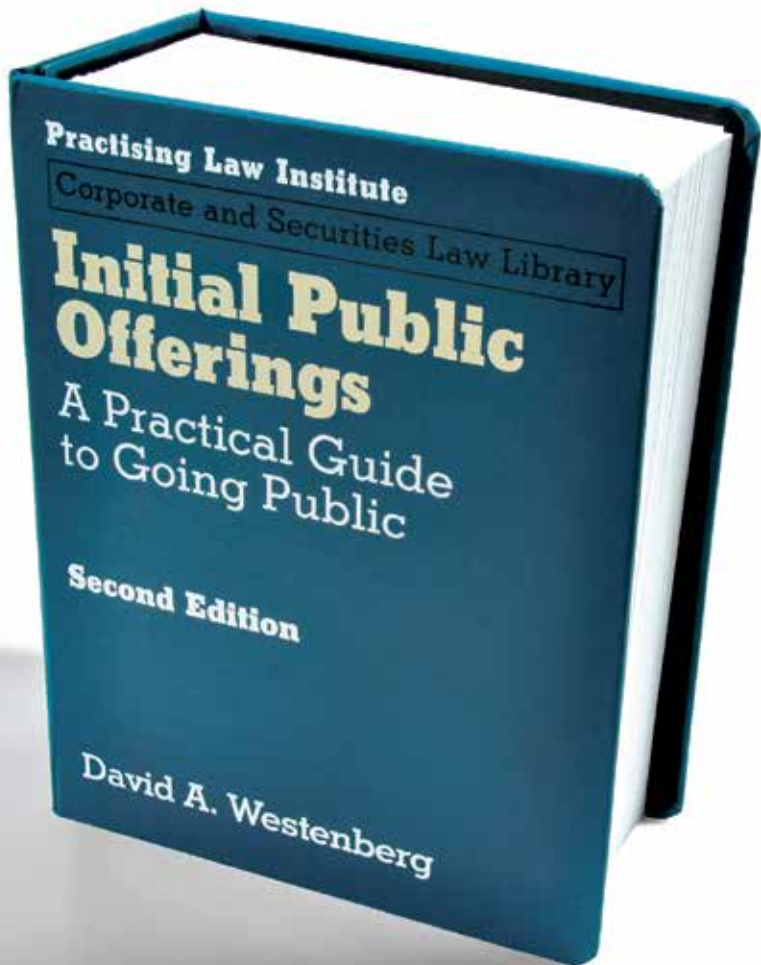
- *Extra Effort and Expense:* A dual track combines the rigors of an IPO with the effort of a company sale process, and the added demands of the dual-track process usually arise in a compressed time frame. A few key participants, including the CEO, CFO, general counsel and outside company counsel, usually bear the brunt of the extra burden. The company should seize efficiency opportunities—such as a virtual data room where due diligence materials can be made available to underwriters' counsel and multiple bidders simultaneously—when available. Although the company will not have to pay both an IPO underwriting discount and an M&A success fee, the total transaction expenses in a dual-track strategy usually exceed the expenses of either path alone.

OUTLOOK

A dual-track strategy can maximize a company's liquidity and flexibility, and will often produce a more favorable outcome than either the IPO or M&A process alone. Anecdotal evidence suggests that dual tracks are becoming more common, especially among small-cap and mid-cap technology companies. Prominent transactions—such as Dell's 2008 acquisition of EqualLogic for \$1.4 billion in cash on the eve of EqualLogic's IPO road show, and, more recently, Cisco's agreement to acquire AppDynamics for \$3.7 billion in cash, signed shortly before AppDynamics was scheduled to price its IPO—have highlighted the potential success of dual-track efforts. Dual tracks, as a deliberate or inherent part of the IPO process, are likely to become increasingly prevalent. ■

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— *Don Bulens, CEO of EqualLogic at the time it pursued a dual-track IPO*

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See our *2017 M&A Report* for a detailed review of, and outlook for, the global M&A market. The report offers an update on takeover defenses, looks at key lessons for buyers and sellers considering earnouts, analyzes recent developments in merger control regulation, and discusses common interest privilege protection among deal parties. We also address special considerations in California M&A deals, review acquisition financial statement requirements for IPO companies, compare deal terms in public and private acquisitions, and survey key terms and issues in sales of VC-backed companies.

To request a copy of any of the reports described above, or to obtain additional copies of the *2017 IPO Report*, please contact the WilmerHale Client Development Department at ClientDevelopment@wilmerhale.com or call +1 617 526 5600. An electronic copy of this report can be found at www.wilmerhale.com/2017IPOreport.

Data Sources: WilmerHale compiled all data in this report unless otherwise indicated. Offerings by REITs, bank conversions, closed-end investment trusts, special purpose acquisition companies, oil & gas limited partnerships and unit trusts are excluded from IPO data. Offering proceeds generally exclude proceeds from exercise of underwriters' over-allotment options, if applicable. For law firm rankings, IPOs are included under the current name of each law firm. Venture capital data is sourced primarily from Dow Jones VentureSource. Private equity-backed IPO data is sourced primarily from Thomson Reuters.

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