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INITIAL PUBLIC OFFERINGS

Confidentially Speaking, This Could be a Big Deal
The SEC's Approach to Confidential Submissions

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Even amidst all the other news crowding the headlines these days, it would be hard to miss the many stories discussing the U.S. initial public offering (''IPO'') market. By now, the trends are well-reported. Many promising U.S. companies are choosing to remain privately held longer and defer their IPOs. The once well-defined stages in a company's funding life, from friends and family rounds to angel investor rounds to venture capital rounds to IPO have been disrupted. It is not uncommon for a company to remain private for ten to twelve years prior to pursuing an IPO or an M&A exit. As a result, generally, the companies that undertake IPOs are more mature and have a higher median market capitalization at the time of their IPOs than their predecessors in prior periods. There are fewer smaller IPOs. There now are many investors that are willing to invest in privately held companies, including family offices, sovereign wealth funds, venture and private equity funds, and cross-over funds. The valuations available to promising companies in private financing rounds often may be more attractive than the valuations that may result from an IPO. Some of these developments may account for the ''unicorn'' phenomenon. There are nearly 200 private companies valued by venture capital firms at $1 billion or more and few of these of these companies have taken the plunge and pursued IPOs. Studies indicate that the number of individual investors that own stocks directly has declined and institutional investors are disinclined to invest in small-cap and even smaller mid-cap stocks. Companies are experiencing much of their most significant growth while they are privately held, rather than in the years immediately following their IPOs, and institutional investors that participate in private funding rounds may stand to benefit most from this growth. In light of all of these changes, it is understandable that policymakers are focused on the ways to revive the U.S. IPO market and make regulatory changes that may remove some of the perceived impediments to pursuing public offerings.

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New Policy

Against this backdrop, in June 2017, the Securities and Exchange Commission (the ''Commission'' or ''SEC'') announced a new policy to make the confidential submission process for registration statements more broadly available. The Jumpstart Our Business Startups Act (the ''JOBS Act'') allowed a new category of issuers, emerging growth companies ("EGCs"), to submit their IPO registration statements for the Commission's confidential review. The confidential submission and review process has been one of the most popular aspects of the JOBS Act. Approximately 90% of EGCs have submitted their IPO registration statements on a confidential basis in the last two years. The ability to make a confidential submission enables an issuer to avoid the glare of publicity for a time while the issuer assesses whether an IPO will be well-received by investors. An EGC can engage in test-the-waters meetings with institutional investors to gain meaningful insight on valuation issues and assess market conditions. Also, an EGC also can address any accounting or other comments made by Commission Staff during the confidential phase. Should the market not prove hospitable to an IPO, the issuer can choose not to file publicly without the stigma often associated with a "failed" or a "withdrawn" offering. Of course, during the confidential phase, an issuer also can evaluate M&A opportunities. While it is unlikely that the ability to submit an IPO registration statement for confidential review can be attributed to any increased willingness on the part of companies to pursue IPOs, confidential submissions may ease the path to an offering. For the last several years, legislators have introduced bills that would have extended many of the accommodations made available to EGCs by the JOBS Act to issuers generally. These bills, often termed "JOBS Act 2.0," have failed to gain bipartisan approval in the deeply divided Congress.

The Commission took the initiative. Since July 10, 2017, all companies, including foreign private issuers and Canadian issuers that rely on the Multijurisdictional Disclosure System, may submit draft IPO registration statements for confidential review. Foreign private issuers may elect to benefit from this new guidance, the procedures available to EGCs (if they so qualify) or the Division of Corporation Finance staff guidance issued on May 30, 2012. As is the case for EGC IPO issuers, any issuer that avails itself of the confidential submission process for its IPO must publicly file its registration statement at least 15 days before the date on which the issuer conducts a road show, as such term is defined in Securities Act Rule 433(h)(4). A foreign private issuer that relies on the accommodations available to EGCs or on this new policy will have to comply with the requirement to file publicly at least 15 days prior to commencement of its roadshow, which would not apply under the Staff's 2012 guidance. The Commission did not extend any of the other JOBS Act benefits (i.e., the ability to test the waters or reduced disclosure requirements) to non-EGC IPO issuers. However, the new policy does permit an IPO issuer to omit financial information that the issuer reasonably believes will not be required at the time that the registration statement is publicly filed. Perhaps signaling more changes ahead, shortly after announcing this new policy, the Commission Chair noted in public remarks that the Commission remains willing to consider requests made pursuant to Regulation S-X Rule 3-13 to modify financial reporting requirements to the extent that certain required disclosures are burdensome and their omission would not affect adversely the total mix of information available to investors. Also in public comments, representatives of the Commission, including the Chair, reiterated the Commission Staff's disclosure effectiveness initiative, which is intended to identify disclosure requirements that may be repetitive or redundant, outdated, or otherwise unnecessary.

Following its announcement, the Staff of the Division of Corporation Finance released frequently asked questions related to the new confidential submission process. As a result of the JOBS Act, there is a specific provision in the Securities Act relating to confidential submissions made by EGCs that protect these submissions from disclosure under the Freedom of Information Act. While the actual process for submission of draft registration statements through the Commission's EDGAR system will be the same for submissions made in reliance on the new procedures, the Staff noted that issuers may seek confidential treatment when submitting responses to Staff comments on draft registration statements. The FAQs note that an issuer should consider requesting confidential treatment under Rule 83 for its draft registration statements and comment letters. In addition, the FAQs addressed public communications made in connection with the submission of draft registration statements. The Staff noted that the Securities Act Rule 134 safe harbor for public communications is not available until the issuer files a registration statement that satisfies the requirements of Rule 134. The issuer may make a public communication about its draft registration statement in reliance on Securities Act Rule 135, but a public statement about its offering may affect whether the Commission can withhold the draft registration statement in response to a request under the Freedom of Information Act.

It is not clear that making confidential submissions more broadly available to IPO issuers will have a prompt or discernible impact on the U.S. IPO market. The Chair of the Commission alluded to disclosure burdens weighting the balance in favor of companies choosing to stay private longer. However, most private companies and their founders seem more keenly focused on the fact that the advantages once associated with being a public company may no longer be so compelling, especially given the availability of private capital. Research coverage, secondary market liquidity, the short-term focus of many investors and the resulting lack of flexibility for management teams to focus on long-term goals, and litigation risks may be more significant issues than disclosure requirements.

Follow-On Offerings

The Commission also extended the ability to make confidential submissions for EGCs and other issuers in connection with offerings undertaken within the first twelve months after the issuer has become an SEC-reporting company. In the case of a follow-on offering within the first twelve months following the effective date of the IPO or a Section 12(b) registration statement, the issuer must file publicly at least 48 hours prior to any requested effective time and date. An issuer relying on the confidential submission process for follow-on offerings cannot file amendments on a confidential basis, it can only make the first submission of the follow-on registration statement on a confidential basis. The ability to submit a follow-on registration statement for confidential review in the period immediately following an IPO is an important development. The U.S. capital markets have undergone significant changes in recent years. Almost all follow-on offerings are now undertaken as takedowns off of effective shelf

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registration statements (once issuers become eligible to use a shelf registration statement) and involve only abbreviated "public" marketing. Most follow-on offerings are structured as confidentially marketed public offerings or as accelerated marketed offerings in order to avoid subjecting issuers to shorting activity in their stocks. As we have previously noted in our writings, while "private" offerings have become more public, public offerings have become more "private." In the period during which an issuer has not yet become eligible to file a shelf registration statement and cannot undertake a confidentially marketed public offering, this new ability to submit a follow-on registration statement for confidential review allows issuers to avoid subjecting themselves to stock price volatility for an extended period. An issuer can make a confidential submission in respect of its follow-on registration statement and plan the timing of the follow-on offering once it understands whether the registration statement will be subject to Staff review. It is easy to envision that the issuer, the underwriters, and their advisers will work together to plan the timing of investor outreach and marketing with the 48-hour period in mind once a review or no-review determination has been made.

Direct Listings

Finally, and perhaps most important, the Commission also now will permit an issuer to submit for confidential review a registration statement filed to register a class of securities under the Securities Exchange Act of 1934 (the "Exchange Act"), such as a registration statement on Form 10 for a U.S. issuer or a Form 20-F for a foreign private issuer. An issuer must publicly file an Exchange Act registration statement at least 15 days prior to seeking its effectiveness. For certain classes of issuers, and given changes in market structure, the ability to pursue a "direct listing" may be very meaningful. The traditional path to becoming an SEC-reporting company always has been an IPO, which entails volitionally filing a registration statement under the Securities Act and raising capital while contemporaneously listing a class of securities on a national securities exchange. Of course, an issuer also could become subject to the Commission's Exchange Act reporting requirements if the issuer has crossed the Exchange Act Section 12(g) threshold based on revenues and the number of holders of record. Finally, an issuer can choose to register a class of its securities under the Exchange Act and list its securities on an exchange without undertaking a capital raise. Often referred to as a "backdoor IPO" or a "Form 10 IPO," this approach was little used. Some life sciences companies have undertaken listings during periods in which the IPO window was closed. However, for small and mid-cap companies, this approach of undertaking a listing without having undergone an IPO and without the sponsorship of underwriters that subsequently support aftermarket trading and provide research coverage, has yielded mixed results.

So what's changed that may now make direct listings appealing? The answer as to micro-cap and small-cap companies is likely not much. However, for larger companies, the answer is probably different. As discussed above, attractive privately held companies and especially unicorns are able to raise capital in the private markets at attractive valuations. For such companies, pursuing an IPO may no longer be about raising capital since they can accomplish that more efficiently in private placements. Even if they no longer need to undertake IPOs to raise capital, these companies may nonetheless be interested in having a class of securities listed on a national securities exchange. Stock-based compensation remains important to tech-based companies. Recruiting and retaining talented employees often entails providing a path to liquidity opportunities so that these employees can monetize their holdings. Private secondary markets help, but may not be the most desirable long-term solution. For companies with an acquisition strategy having an acquisition currency in the form of a class of listed securities may be an important factor. The investors in private rounds also may seek liquidity opportunities that may only come with having a class of securities listed on a securities exchange.

The challenges that biotech Form 10 issuers encountered likely would not arise for unicorns undertaking direct listings. Unicorns tend to have fairly dispersed holders that are sophisticated investors. These companies are well-followed by investment banks and in the press already, even without their having undertaken IPOs. A unicorn, advised by financial intermediaries acting as advisers (not underwriters), likely will be able to attract the attention of additional or new institutional investors that might purchase its securities in the secondary market. These same financial intermediaries, or others familiar with the company, might provide research coverage following the listing of its stock on a securities exchange. As a result, it is possible that for a sufficiently large and well-recognized company, a direct listing might yield many of the same benefits of an IPO perhaps with reduced costs and with greater control in the hands of the company. A unicorn that has raised capital in successive private rounds also may be sensitive to valuation considerations. It is possible that a company undertaking a direct listing might begin trading at a price closer to the price at which it completed its immediately prior round of private financing. For a foreign private issuer that already has a class of securities listed on a securities exchange in its home country or on another exchange that has limited liquidity, a direct listing on a securities exchange in the United States also may be an effective alternative to a traditional IPO. While it is impossible to predict with any accuracy whether direct listings may be the new route to public company status for unicorns, it is certainly helpful that the Commission is facilitating the possible new approach.

Conclusion

In the three decades during which we have been focused on the U.S. equity capital markets, we have seen enormous changes. There is no reason to expect that enormous changes will not continue to occur. The Commission's recently announced policy of expanding the confidential submission process has the potential to change the way in which securities are offered in follow-on transactions and influence the way in which issuers become SEC-reporting companies.