IPO Report

2021

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2021 IPO Report – What's Inside

REVIEW

Across the board, despite the pall cast by the COVID-19 pandemic, 2020 was a year of strong IPO deal flow and aftermarket performance, punctuated by a breathtaking surge in IPOs by special purpose acquisition companies (SPACs).

Excluding SPAC IPOs and direct listings, the conventional IPO market produced 209 IPOs in 2020, an increase of one-third from the 157 IPOs in 2019, and the second-highest annual count since 2000, trailing only the 244 IPOs achieved in 2014.

Total gross proceeds for the year were $76.32 billion, a figure that surpassed 2019's $45.32 billion tally by 68% and eclipsed 2014's $74.39 billion total to become the highest annual figure since 2000.

IPOs by emerging growth companies (EGCs) accounted for 90% of the year's IPOs—down from 92% in 2019 but still higher than the overall 88% market share for EGCs that has prevailed since the enactment of the JOBS Act in 2012.

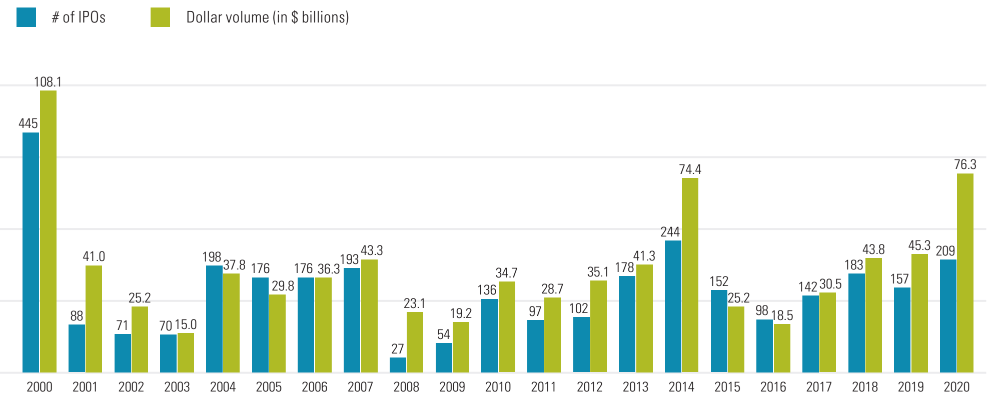
The median offering size for all 2020 IPOs was $180.0 million, an increase of 69% from the $106.7 million median for 2019 and 28.2% higher than the previous annual high of $140.4 million in 2011.

In 2020, the median offering size for IPOs by EGCs was $160.0 million, 65% higher than the $96.9 million in 2019. The median non-EGC offering size in 2020 was $1.17 billion, more than double the $544.5 million median in 2019.

The median annual revenue of all IPO companies in 2020 was $31.0 million, down 64% from the $85.0 million median in 2019, and the lowest annual level since the $17.6 million median in 2000.

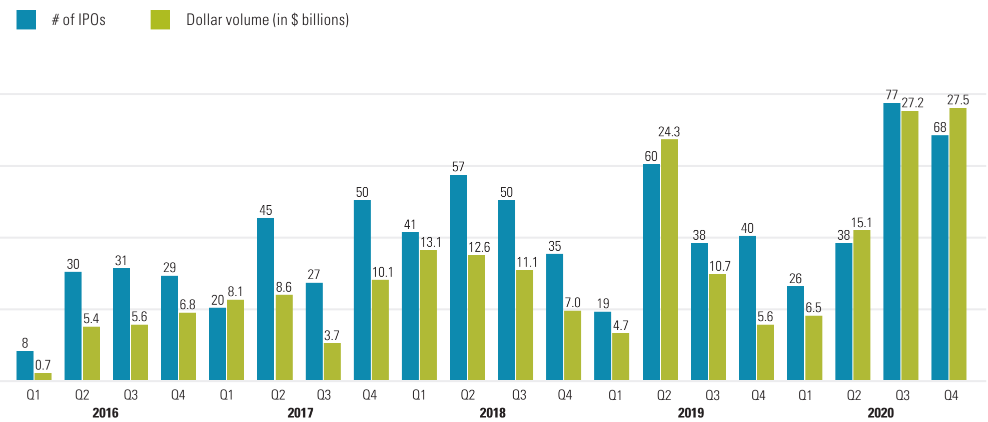
In 2020, 53% of life sciences IPO companies had revenue, up from 43% in 2019, although the median annual amount was a negligible $0.1 million. Among non–life sciences IPO companies in 2020, median annual revenue was $197.2 million, 34% above the $147.1 million median in 2019.

US IPOs by Year – 2000 to 2020



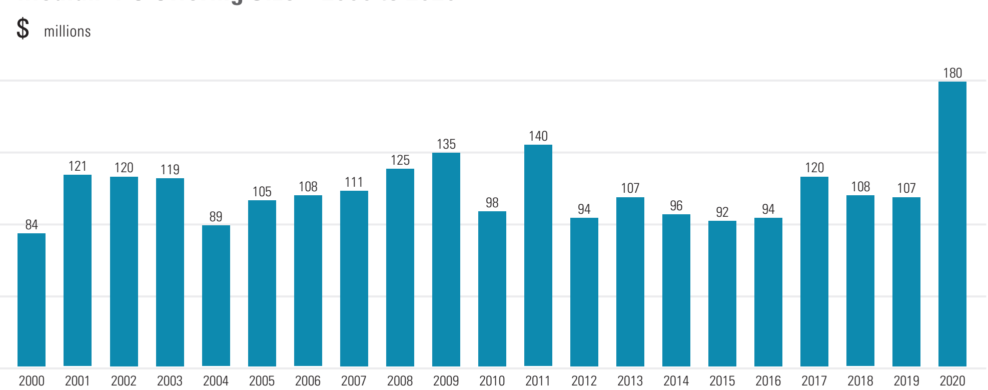
Source: SEC filings

US IPOs by Quarter – 2016 to 2020



Source: SEC filings

Median IPO Offering Size – 2000 to 2020



Source: SEC filings

EGC IPO companies in 2020 had median annual revenue of $20.2 million, compared to $3.16 billion for non-EGC IPO companies—representing the lowest and highest annual figures, respectively, for these measures since the enactment of the JOBS Act.

The percentage of profitable IPO companies declined to 22% in 2020, from 32% in 2019. Only 5% of life sciences IPO companies were profitable in 2020, compared to 40% of non–life sciences companies.

In 2020, the average IPO produced a first-day gain of 36%, compared to 19% in 2019. The average first-day gain in 2020 was the highest annual figure since the 53% in 2000.

The average first-day gain for life sciences IPO companies in 2020 was 40%, compared to 33% for non–life sciences IPO companies. In 2019, the average first-day gain for life sciences companies was 19%—less than half a percent higher than that of non–life sciences IPO companies.

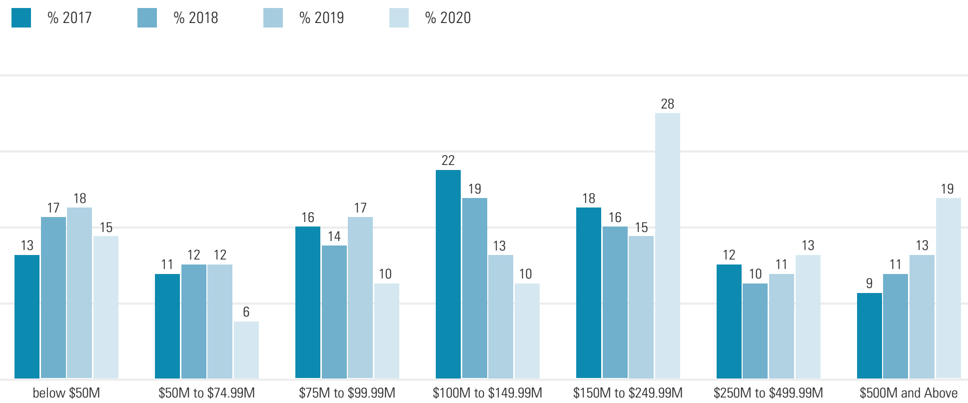
There were 23 "moonshots" (IPOs that double in price on their opening day) in 2020, up from three in 2019. The 2020 figure equals the total number of moonshots that occurred over the seven-year period from 2012 to 2018.

In 2020, 21% of IPOs were "broken" (IPOs whose stock closes below the offering price on their first trading day), down from 31% in 2019. Life sciences company IPOs accounted for 18% of broken IPOs in 2020, compared to 24% for non–life sciences company IPOs.

Overall, the average 2020 IPO company ended the year 77% above its offering price. The year's best-performing IPO was Chinese online food retailer Wunong Net Technology (trading 651% above its offering price at year-end), followed by life sciences companies Greenwich LifeSciences (534%), CureVac (407%) and Beam Therapeutics (380%).

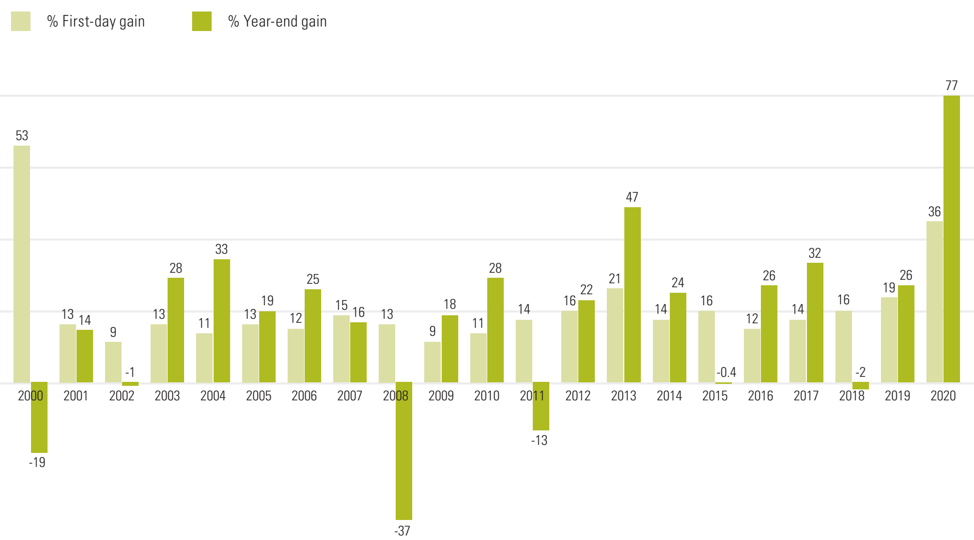
At the end of 2020, 76% of the year's IPO companies were trading above their offering price. Life sciences companies fared better than their non–life sciences counterparts, with

Distribution of IPO Offering Size – 2017 to 2020

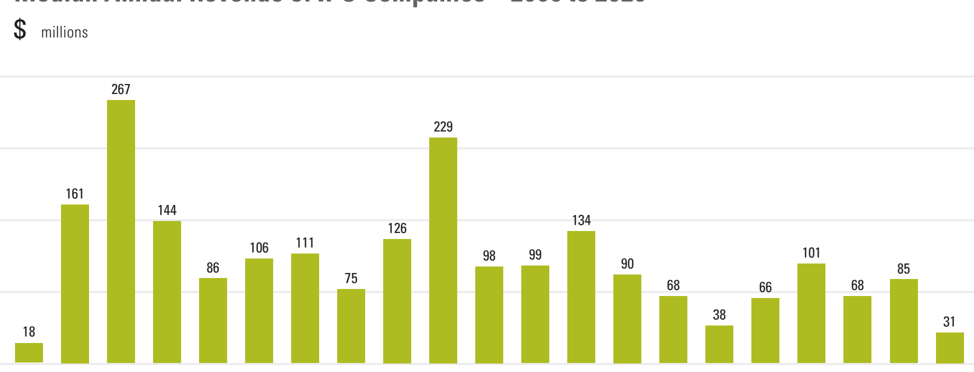


Source: SEC filings

Average IPO First-Day and Year-End Gain by Year – 2000 to 2020



Median Annual Revenue of IPO Companies – 2000 to 2020



Source: SEC filings and IPO Vital Signs

81% trading above their offering price, compared to 70% of other companies.

Individual components of the IPO market fared as follows in 2020:

— ***VC-Backed IPOs:*** The number of IPOs by venture capital–backed US issuers increased by 32%, from 72 in 2019 to 95 in 2000—the highest annual figure since the 102 in 2014—with the market share of this segment dipping from 65% to 64%. The median offering size for US VC-backed IPOs increased by 65%, from $110.5 million in 2019 to $182.7 million in 2020, topping the median offering size for non–VC-backed companies for the second consecutive year (the only two times this has occurred since 2000). On average, US issuer VC-backed IPO companies gained 104% from their offering price through year-end.

— ***PE-Backed IPOs:*** The number of private equity–backed IPOs by US issuers increased by 88%, from 16 in 2019 to 30 in 2020. Overall, PE-backed issuers accounted for 20% of all US-issuer IPOs in 2020, compared to 14% in 2019. The median offering size for PE-backed IPOs in 2020 was $674.1 million, up 185% from the $236.4 million median in the prior year and considerably higher than the $157.4 million median for other 2020 IPOs. On average, PE-backed IPO companies ended the year 58% above their offering price.

— ***Life Sciences IPOs:*** There were 104 life sciences company IPOs in 2020, an increase of 65% from the 63 in 2019. The portion of the IPO market accounted for by life sciences companies increased to 50% in 2020 from 40% in 2019. The median offering size for life sciences IPOs in 2020 was $159.1 million, a 93% increase from the $82.5 million in 2019. Through year-end, on average, life sciences IPO companies gained 92% from their offering price, compared to 61% for non–life sciences IPO companies in 2020.

— ***Tech IPOs:*** Deal flow in the technology sector increased by 17%, from 59 IPOs in 2019 to 69 IPOs in 2020, marking the fifth consecutive year of growth. While the tech sector's share of the US IPO market decreased from 38% in 2019 to 33% in 2020, it remained higher than the industry's 31% market share in 2018. The median offering size for tech IPOs in 2020 was $319.0 million, up 75% from $182.0 million in 2019. On average, tech IPO companies ended the year 75% higher than their offering price.

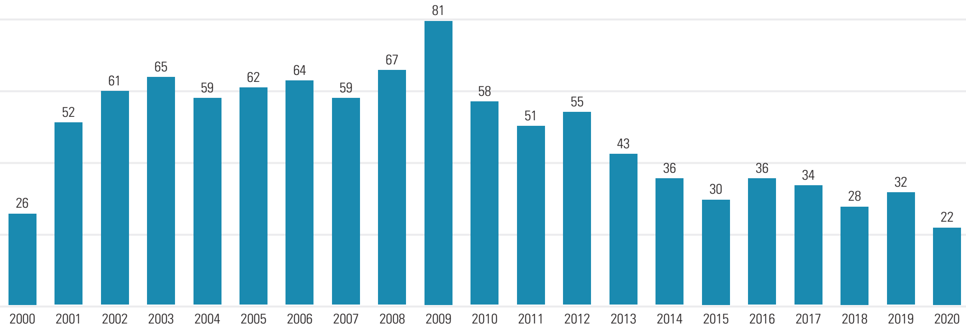
— ***Foreign-Issuer IPOs:*** The number of US IPOs by foreign issuers increased by 30%, from 46 in 2019 to 60 in 2020 (representing 29% of the market in both years). The 2020 tally represents the highest annual number of foreign-issuer IPOs since the 107 in 2000. Among foreign issuers, Chinese companies led the year with 31 IPOs (China's second-highest annual total since 2010, behind only the 32 in 2018), followed by companies from Canada and the United Kingdom (each with five IPOs) and Israel (three IPOs). On average, foreign-issuer IPO companies ended the year up 53% from their offering price.

DIRECT LISTINGS

A "direct listing," in which a private company files a registration statement to register the resale of outstanding shares and concurrently lists its shares on a stock exchange, provides an alternative path to public ownership and liquidity. There were three direct listings in 2020, up from two in the prior year, and one—the first direct listing—in 2018. Although the technique remains in its infancy, one direct listing was completed in the first quarter of 2021 and more can be expected in the coming year. Direct listings are discussed in more detail on pages 12–13.

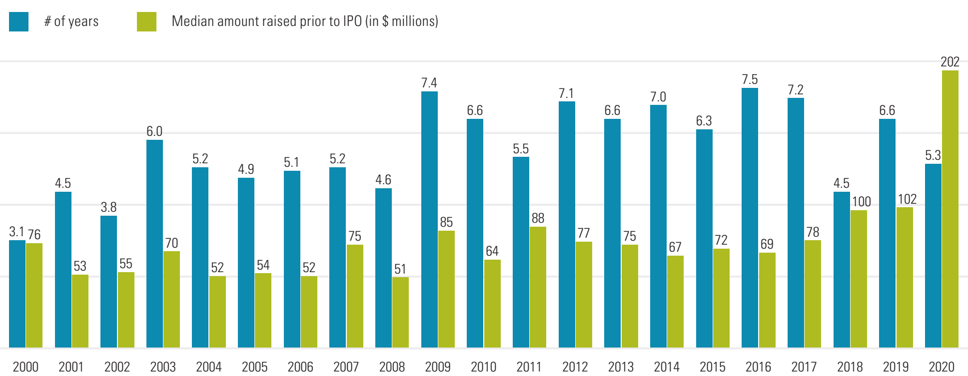
Percentage of Profitable IPO Companies – 2000 to 2020

%



Source: SEC filings and IPO Vital Signs

Median Time to IPO and Median Amount Raised Prior to IPO – 2000 to 2020



Source: Pitchbook

US Market Review and Outlook

In 2020, 71 companies based in the eastern United States (east of the Mississippi River) completed IPOs, compared to 78 western US–based issuers. California led the state rankings with 52 IPOs, followed by Massachusetts (27 IPOs), New York and Texas (ten IPOs each), and Pennsylvania (seven IPOs).

OUTLOOK

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

— ***Economic Growth:*** With many sectors of the economy hammered by the pandemic, US economic growth contracted by 3.5% in 2020. After wild swings in the GDP in the second and third quarters, the 4.3% growth in the fourth quarter points to a gradual recovery that will depend in part on the widespread availability of COVID-19 vaccines and the enactment of economic stimulus legislation.

— ***Capital Market Conditions:*** The major US stock indices recovered from sharp declines in the first quarter of the year to post remarkably resilient gains in 2020, with the Dow Jones Industrial Average up 7%, the Nasdaq Composite Index up 44% and the S&P 500 up 16%. While the uncertain economic outlook may temper broader market gains, the strong aftermarket performance of recent IPOs should make IPOs attractive to investors seeking investments with the potential to outperform the major indices.

— ***Venture Capital Pipeline:*** Although many VC-backed companies continue to be able to raise private "IPO-sized" rounds and delay their public debuts, the desire of investors for cash returns, combined with the solid aftermarket performance of some of last year's largest debuts by VC-backed companies, is likely to entice more VC-backed companies to the public markets in the coming year.

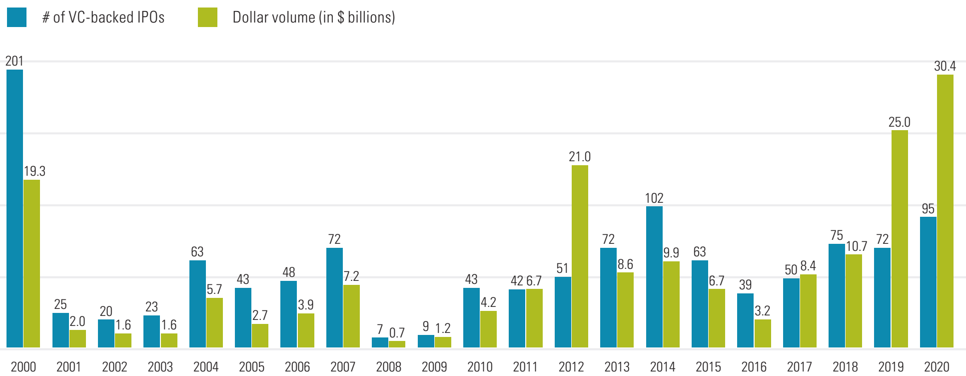
— ***Private Equity Impact:*** Although fundraising by US private equity firms dropped from the prior year, more than $200 billion was raised in 2020, and PE firms continue to hold large amounts of "dry powder" to deploy. In recent years, the supply of capital has intensified competition for attractive deals and driven up prices, making it harder for PE firms to allocate investments profitably. At the same time, PE firms face pressure to exit investments—via IPOs or sales of portfolio companies—and return capital to investors.

The first quarter of 2021 produced 97 IPOs with gross proceeds of $38.81 billion, representing the most active three-month period in the last twenty years. March alone produced 41 IPOs—the highest monthly count since August of 2000. While the timing and extent of economic recovery is uncertain, the abundance of investment capital in the market, coupled with a deep pool of exciting IPO candidates, is likely to mean continued momentum in the IPO market in the coming year. ■

SPAC IPOS

In 2020, there were 248 SPAC IPOs with gross proceeds of $75.73 billion, up dramatically from the 2019 tally of 59 SPAC IPOs with gross proceeds of $12.07 billion. The number of SPAC IPOs in 2020 exceeded the combined total for the preceding 12 years. In 2020, deal flow in the SPAC IPO market overtook the conventional IPO market for the first time, while gross proceeds were nearly equal. These trends accelerated in the first quarter of 2021, with 298 SPAC IPOs raising $87.01 billion in the first three months of the year—more than the totals for all of 2020—far outpacing the conventional IPO market despite its very strong first quarter. Based on the volume of new filings in the first quarter of 2021, absent some significant intervening event, many more SPAC IPOs can be expected in the coming year. The SPAC market is discussed in more detail on pages 18–21.

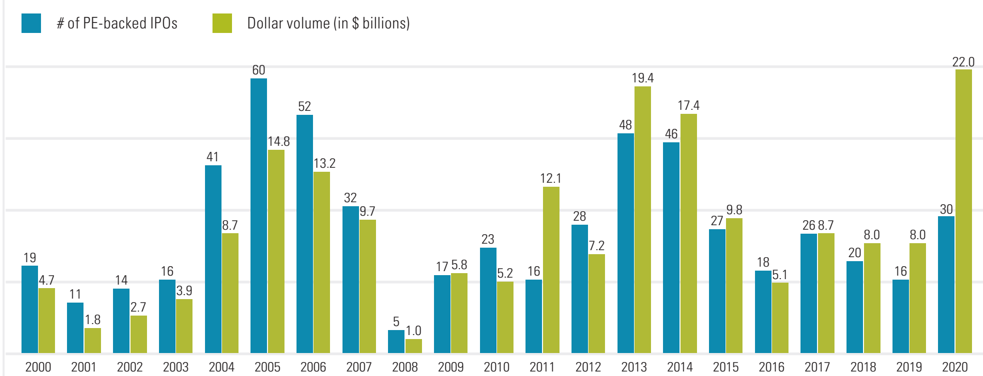
Venture Capital–Backed IPOs – 2000 to 2020



Source: SEC filings

Based on US IPOs by VC-backed issuers

Private Equity–Backed IPOs – 2000 to 2020



Source: Refinitiv and SEC filings

Based on US IPOs by PE-backed issuers

CALIFORNIA

The number of California IPOs increased for the fourth consecutive year, growing by 8%, from 48 in 2019 to 52 in 2020—the highest yearly count since the 54 IPOs in 2014.

Buoyed by the three largest US IPOs in 2020, gross proceeds increased by 18%, from $20.94 billion in 2019 to a record annual total of $24.70 billion in 2020.

The largest California IPO in 2020 came from Airbnb ($3.49 billion), followed by offerings from DoorDash ($3.37 billion), Snowflake ($3.36 billion) and Maravai LifeSciences ($1.62 billion).

Technology and life sciences companies accounted for 90% of the state's IPO total in 2020, up from their 81% share in 2019—a year that saw a higher than usual proportion of IPOs by consumer goods and financial services companies.

The number of venture-backed California IPOs increased from 36 in 2019 to 42 in 2020. The 2020 tally represents 44% of all US-issuer VC-backed IPOs, down from 50% in 2019, but still higher than the 42% that prevailed over the five-year period from 2014 to 2018.

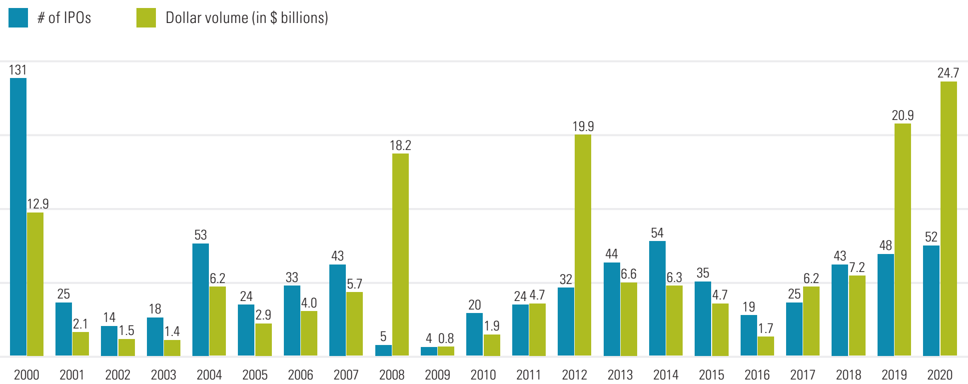
The average 2020 California IPO produced a first-day gain of 57%. A trio of life sciences companies were the state's top performers, with Berkeley Lights up 198% in first-day trading, followed by Seer (up 197%) and Nkarta (up 166%).

At year-end, 88% of the state's 2020 IPOs were trading above their offering price, with the average California IPO up 99% from its offering price.

The best-performing California IPO of the year was Greenwich LifeSciences (up 534% at year-end), followed by Shattuck Labs (up 208%), Oak Street Health (up 191%) and BigCommerce Holdings (up 167%).

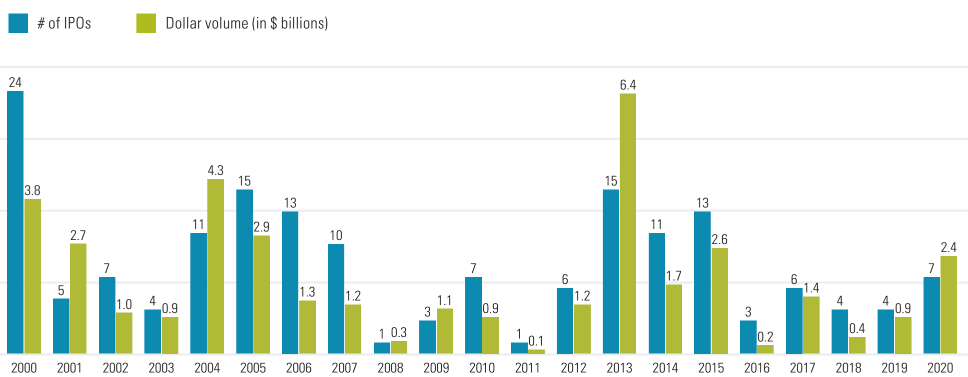
With the largest pool of venture capital–backed companies in the United States and a wealth of entrepreneurial talent, California should remain a major source of attractive IPO candidates in the coming year, particularly from the technology and life sciences sectors.

California IPOs – 2000 to 2020



Source: SEC filings

Mid-Atlantic IPOs – 2000 to 2020



Source: SEC filings

MID-ATLANTIC

The mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia produced seven IPOs in 2020, up from four in 2019 but below the annual double-digit count that prevailed from 2013 to 2015.

Delaware, Maryland and North Carolina each produced two of the region's IPOs in 2020, with Virginia contributing the remaining one.

Gross proceeds in the mid-Atlantic region more than doubled, growing from $851 million in 2019 to $2.38 billion in 2020. The largest mid-Atlantic IPOs of 2020 came from North Carolina–based PPD ($1.62 billion) and Virginia-based Telos ($255 million).

The average 2020 mid-Atlantic IPO produced a first-day gain of 36%, led by nCino (up 195%) and Prelude Therapeutics (up 38%).

At year-end, the average mid-Atlantic IPO was trading up 108% from its offering price, led by Prelude Therapeutics (up 277%), Fathom Holdings (up 260%) and nCino (up 134% after retreating from its 195% first-day gain).

Although the mid-Atlantic region's IPO deal flow improved in 2020, its activity remains below peak levels. Assuming market conditions are conducive, the region's traditional strengths in the life sciences, technology, financial services and defense sectors should help it build on last year's uptick in IPOs.

NEW ENGLAND

The number of New England IPOs almost doubled, spiking to 29 in 2020 from a total of 15 in 2019.

Massachusetts accounted for all but two of the region's IPOs in 2020—the state's tally of 27 IPOs was the second-highest state total in the country for the seventh consecutive year, trailing only California—with Connecticut and New Hampshire each adding one.

Gross proceeds in the region more than tripled, from $1.81 billion in 2019 to $6.28 billion in 2020.

The largest New England IPO in 2020 was by American Well ($742 million), followed by Datto ($594 million) and Duck Creek Technologies ($405 million).

The region's 25 life sciences company IPOs in 2020 represented 30% of all life sciences IPOs in the country by US issuers, up from 26% in 2019.

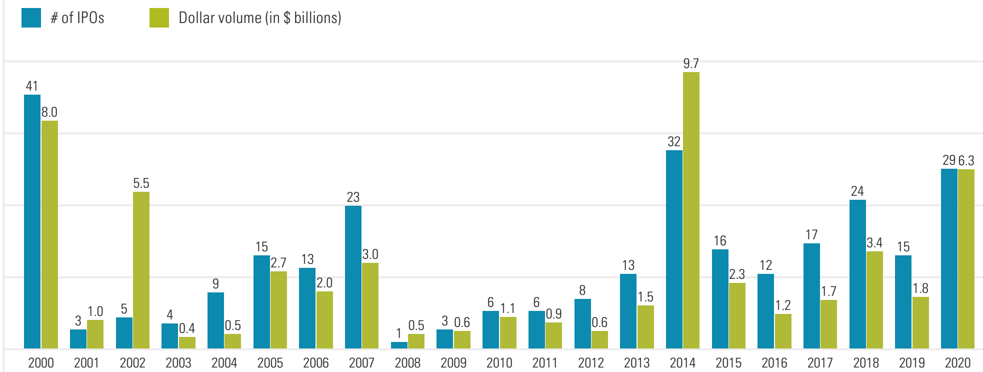
The number of venture-backed New England IPOs increased from 14 in 2019 to 26 in 2020. The region accounted for 27% of all US-issuer VC-backed IPOs in 2020, up from 19% in 2019 but slightly below the 28% in 2018.

The average 2020 New England IPO produced a first-day gain of 33%. The region's top performer in first-day trading was 908 Devices (up 145% from its offering price), followed by Black Diamond Therapeutics (up 108%) and Forma Therapeutics (up 95%).

At year-end, the average New England IPO was up 93% from its offering price, with all but three of the region's IPOs trading above their offering price, led by Beam Therapeutics (up 380% at year-end), Keros Therapeutics (up 341%) and Kymera Therapeutics (up 210%).

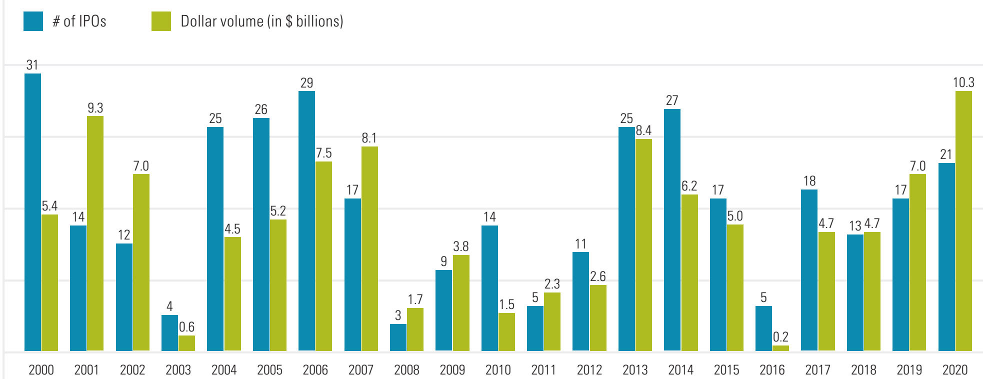
With the region's world-renowned universities and research institutions continuing to spawn tech and life sciences companies, and with strong levels of venture capital investment, New England should continue to generate attractive IPO candidates in the coming year.

New England IPOs – 2000 to 2020



Source: SEC filings

Tri-State IPOs – 2000 to 2020



Source: SEC filings

TRI-STATE

The number of IPOs in the tri-state region of New York, New Jersey and Pennsylvania increased by 24%, from 17 in 2019 to 21 in 2020.

New York produced ten of the region's 2019 IPOs, with Pennsylvania accounting for seven and New Jersey the remaining four.

Gross proceeds from tri-state IPOs increased by 46%, from $7.03 billion in 2019 to $10.26 billion in 2020, led by Royalty Pharma ($2.18 billion) and Warner Music Group ($1.93 billion).

There were 12 venture-backed IPOs in the tri-state region in 2020, up one from the prior year. The 2020 total equaled the region's highest annual figure since 2000.

The average 2020 tri-state IPO produced a first-day gain of 54%. The region's top performers in first-day trading were Lemonade (up 139% from its offering price), Applied UV (up 132%) and Vroom (up 118%).

At year-end, the average tri-state IPO was up 103% from its offering price. The best-performing tri-state IPO was by Schrödinger (up 366% from its offering price at year-end), followed by Lemonade (up 322%) and PMV Pharmaceuticals (up 242%).

With a high level of venture capital activity in the region, the coming year should see tri-state IPOs from emerging life sciences and technology companies and larger, private equity–backed companies. ■

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. An IPO is not the best time for a fledgling CEO or CFO to cut his or her teeth.

— **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, such as life sciences, patents are *de rigueur.*

— **Substantial Revenue:** Substantial revenue is generally 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, although IPO investors often appear to value growth more highly than near-term profitability.

— **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 during the three-year period from 2018 through 2020.

Percentage of IPO companies qualifying as EGCs under JOBS Act	91%
Median offering size	$128.4 million (17% below $50 million and 15% above $500 million)
Median annual revenue of IPO companies	$59.5 million (48% below $50 million and 15% above $500 million)
Percentage of IPO companies that are profitable	27%
State of incorporation of IPO companies	Delaware—91% No other state over 3%
Percentage of IPOs including selling stockholders, and median percentage of offering represented by those shares	Percentage of IPOs—18% Median percentage of offering—26%
Percentage of IPOs including directed share programs, and median percentage of offering represented by those shares	Percentage of IPOs—45% Median percentage of offering—5%
Percentage of IPO companies disclosing adoption of ESPP	64%
Percentage of IPO companies using a "Big 4" accounting firm	77%
Stock exchange on which the company's common stock is listed	Nasdaq—73% NYSE—27%
Median underwriting discount	7%
Number of SEC comments contained in initial comment letter	Median—16 25th percentile—12 75th percentile—22
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	Median—74 calendar days 25th percentile—56 calendar days 75th percentile—120 calendar days
Time elapsed from initial confidential submission or initial public filing to effectiveness of Form S-1	Median—112 calendar days 25th percentile—84 calendar days 75th percentile—182 calendar days
Median offering expenses	Legal—$1,646,000 Accounting—$961,000 Total—$3,500,000

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. ■

IPOs have weathered cyclicality, economic uncertainty, market upheavals, bubbles, regulatory reforms and occasional scandals to remain a fixture in the financing landscape. Beginning in March 2020, the IPO market faced a new foe—the COVID-19 pandemic—and scarcely missed a beat. With most of the business world working from home, the IPO process has become completely virtual, producing no adverse consequences while yielding unexpected efficiencies that are likely to persist in the post-pandemic world.

IMPACTS ON IPO PROCESS

— ***Overall Timeline:*** The median time between the initial Form S-1 filing or submission and effectiveness declined from 112 days in 2019 to 105 days in 2020—the lowest annual figure since at least 2007. Although timelines are affected by multiple factors, the pandemic does not appear to be slowing down the overall IPO process.

— ***Due Diligence:*** The universal use of virtual data rooms has prevented the pandemic from having any effect on documentary due diligence. Site visits—which ordinarily are not undertaken outside of manufacturing and certain other industries—are conducted in accordance with local COVID-19 protocols.

— ***All-Hands Meetings:*** Org meetings and drafting sessions are being held remotely by videoconference and proceeding seamlessly. Even before the pandemic, many in-person meetings had shifted online—drafting sessions, for example, are often conducted remotely, with the registration statement displayed on the screen for group discussion and editing.

— ***Company Disclosures:*** During 2020, the SEC staff issued guidance on disclosure considerations arising from the pandemic and its impact on company operations, liquidity and capital resources. Pandemic-related disclosures are now commonplace in risk factors, MD&A (with a focus on known trends and uncertainties associated with the pandemic) and elsewhere in IPO prospectuses.

— ***SEC Rule Amendments:*** The SEC has taken several steps to facilitate document submissions. Most importantly, the SEC adopted rules to permit the use of electronic signatures generated by DocuSign and other e-signature applications when filing registration statements and other documents. The SEC also temporarily suspended notarization requirements for obtaining EDGAR filer codes and established a temporary secure file transfer process for the electronic submission of supplemental materials.

— ***Submission Process:*** The lack of in-person meetings is not affecting the ability of working groups to finalize the Form S-1 before each filing or submission. In recent years, lengthy in-person sessions at the financial printer had already begun to disappear, in favor of shorter sessions to fine-tune the Form S-1 just before submission.

— ***SEC Review:*** The nature and timing of SEC review is unchanged (even before the pandemic, many staff members worked remotely).

— ***Marketing:*** Road show and "test-the-waters" meetings are held virtually, enabling company management to meet remotely with more potential investors in less time than required by in-person meetings—while saving money on travel expenses. With travel time eliminated and investor meetings held virtually, road show schedules have become shorter—thereby reducing exposure to market risk. Electronic road shows continue to supplement live road show meetings for retail investors.

— ***Pricing and Closing:*** No IPOs have been cancelled after pricing, despite the unprecedented market volatility that has prevailed at times. Remote closings—which had already become the norm—are conducted by telephone and electronic document exchange.

POST-IPO EFFECTS

— ***SEC Filing Deadlines:*** In the first half of 2020, the SEC extended filing deadlines for companies and individuals affected by the pandemic.

— ***Stock Exchange Requirements:*** Nasdaq and the NYSE temporarily suspended compliance with market price–based listing requirements in response to the dramatic market decline that occurred in March 2020. Both exchanges also temporarily suspended, under certain circumstances, the requirement for stockholder approval of private issuances of securities in financing transactions representing or convertible into 20% or more of a listed company's pre-financing outstanding shares or voting power at a price below the minimum price per share specified by the applicable exchange.

— ***Financial Guidance:*** In light of extraordinary economic uncertainty, especially in the early stages of the pandemic, many public companies withdrew pre-pandemic guidance, updated their guidance, or stopped providing guidance altogether. As appropriate, new guidance highlights the uncertainties created by the pandemic.

— ***Annual Meetings:*** Virtual-only annual meetings of stockholders have become commonplace in light of the health and safety concerns posed by in-person meetings and restrictions on the size of public gatherings.

— ***Poison Pills:*** Proxy advisors ISS and Glass Lewis both issued guidance to the effect that the market and economic impacts of the pandemic may justify adoption of a stockholder rights plan of less than one year in duration if the company discloses a sound rationale for adoption of the plan. New plan adoptions in 2020 significantly increased compared to prior years.

— ***Potential Liability and Enforcement:*** According to Cornerstone Research, the number of federal and state securities class action filings declined by 22% from 2019 to 2020, but nineteen of the cases brought in 2020 involved COVID-19 disclosures. The SEC's Division of Enforcement formed a steering committee to focus on coronavirus-related market and investor risk and has begun to bring enforcement actions against public companies for misleading disclosures about the financial effects of the pandemic. ■

Over the past decade, Congress and the SEC have sought to encourage capital formation as an engine of economic growth. The best known of these efforts, the JOBS Act, was adopted in 2012. The JOBS Act created an "IPO on-ramp" that provides "emerging growth companies" (EGCs) with a phase-in period, which can continue 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. The overwhelming majority of all IPO candidates qualify as EGCs.

The JOBS Act makes various items of relief available to EGCs. Practices with respect to EGC relief have varied, often reflecting the company's size, maturity or industry, and have evolved over time in response to investor expectations, market practices and other factors.

As a result of subsequent legislation and SEC actions, additional steps have been taken to further streamline the IPO process, facilitate other public offerings, reduce the burdens on public companies while still protecting investors, and, in some cases, extend to all issuers items of relief otherwise available only to EGCs.

CONFIDENTIAL SUBMISSION OF REGISTRATION STATEMENTS

Confidential Review (EGCs Only)

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 has been widely adopted by EGCs across time periods and sectors—reaching 98% of all EGCs in 2020.

Nonpublic Review (All Issuers)

In 2017, the SEC staff changed its review procedures to allow any company, regardless of EGC status, to submit a draft registration statement for "nonpublic review." The nonpublic review process is similar to the confidential submission process for EGCs but is available for a wider range of offerings and registration statements, including the submission of a draft registration statement (but not amendments thereto) for a follow-on public offering within one year after a company's IPO. Nonpublic review is particularly helpful in a follow-on offering because it enables a company to determine, before public filing, whether the registration statement will be reviewed by the staff, thereby enabling the company to minimize the period of time (as little as 48 hours) between public disclosure and pricing of the offering.

REDUCED FINANCIAL DISCLOSURE

Reduction in Number of Years of Audited Financials Required (EGCs Only)

EGCs may elect to provide only two years of audited financial statements (rather than three) and Management's Discussion and Analysis (MD&A) is only required for the periods presented in the financial statements. The JOBS Act also permitted an EGC to omit selected financial data for any period prior to the earliest period covered by its audited financial statements, but this relief is no longer significant due to the SEC's elimination (effective in 2021) of all requirements to present selected financial data in SEC filings.

Overall, the percentage of EGCs electing to provide two years of audited financial statements has increased dramatically, from 27% in 2012 to 94% in 2020.

- From the outset, life sciences companies, for which older financial information is often irrelevant, were more likely than other companies to provide only two years of audited financial statements, with the percentage choosing this option initially topping 80% and reaching 99% in 2020.
- Technology companies, which generally have substantial revenue and often have profitable operations, have been slower to adopt this practice, with the percentage providing two years of audited financial statements growing from 22% in 2012 to 89% in 2020.
- The pattern among companies in other sectors has been similar to that of technology companies, with the percentage providing two years of audited financial statements growing from 38% in 2013 to 83% in 2020.

In late 2015, the FAST Act amended the JOBS Act to permit an EGC to omit from its Form S-1 financial information that relates to a historical period that the company reasonably believes will not be required to be included in the Form S-1 at the time of the contemplated offering, as long as the company adds all required financial information to the Form S-1 before distributing a preliminary prospectus to investors.

Omission of Other Financial Statements (All Issuers)

Under an SEC staff policy adopted in 2017, any issuer may omit from its draft registration statements submitted for nonpublic review annual and interim financial information that it reasonably believes it will not be required to present separately at the time that it publicly files its registration statement.

Reduced Financial Disclosure for Acquisitions and Dispositions (All Issuers)

Effective January 1, 2021, the SEC amended Regulation S-X to reduce the number of years of required financial statements and alleviate some of the burdens faced by companies in assembling required financial statements with respect to acquisitions and dispositions.

Other Staff Accommodations (All Issuers)

Rule 3-13 under Regulation S-X allows companies to seek SEC relief from financial statement requirements if consistent with the protection of investors. On numerous occasions in recent years, senior staff members have expressed a willingness to consider requests for modifications to financial reporting requirements when required disclosures are burdensome to generate and may not be material to the total mix of information available to investors.

ACCOUNTING AND AUDITING RELIEF

Delayed Application of New Accounting Standards (EGCs Only)

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. In the past few years, a major shift in EGC practices has occurred.

— Through 2016, the vast majority of EGCs, regardless of industry, opted out of the extension of time to comply with new or revised accounting standards. This decision appears to have been motivated by the uncertain value of the deferred application of future, unknown accounting standards, and concerns that a company's election to take advantage of the extended transition period could make it more difficult for investors to compare its financial statements to those of its peers.

— The percentage of EGCs adopting the extended transition period jumped from 11% through 2016 to 63% between January 1, 2017, and December 31, 2020. This trend has been most pronounced among technology companies, with the percentage electing the extended transition period spiking from 12% to 71% between these periods (including 94% in 2020), and life sciences companies, with the percentage increasing from 10% to 62% (including 90% in 2020). This change in behavior appears to have been motivated by the desire of many EGCs to delay the application of the new accounting standards for revenue recognition (ASC 606) and lease accounting (ASC Topic 842) or, at a minimum, to take more time to evaluate the effects of the new standards before adopting them.

Exemption from Future Auditing Standards (EGCs Only)

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 (such as the requirement to make disclosure about critical audit matters (CAMs) under auditing standard AS 3101). 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.

Exemption from Section 404(b) ICFR Audits (EGCs and Eligible SRCs)

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 adopt this exemption at the time it becomes applicable to them.

In 2020, the SEC adopted rules that exempt from the ICFR audit requirement of Section 404(b) all "smaller reporting companies" (SRCs) that have less than $100 million in revenues in the most recent fiscal year for which audited financial statements are available.

REDUCED EXECUTIVE COMPENSATION DISCLOSURE

(EGCs and SRCs)

An EGC may follow the scaled compensation disclosure requirements that apply to SRCs. As a result, EGCs (like SRCs) 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. EGCs have uniformly and overwhelmingly embraced the ability to omit CD&A. In 2020, every EGC omitted CD&A.

TESTING THE WATERS

(All Issuers)

The JOBS Act permits EGCs to engage in "test-the-waters" communications with eligible institutional investors to determine their investment interest in a contemplated IPO. In 2019, the SEC adopted new Rule 163B to permit any company, regardless of its EGC status, to engage in "test-the-waters" communications in connection with any registered securities offering. In many sectors, particularly life sciences and technology, "test-the-waters" meetings have become routine, and interest in such meetings continues to grow among institutional investors. ■

EGC ELECTIONS

Item of Relief	Prevalence of Election											
	Life Sciences			Technology			Other Sectors			All EGCs		
	4/5/12–12/31/16	1/1/17–12/31/20	Overall	4/5/12–12/31/16	1/1/17–12/31/20	Overall	4/5/12–12/31/16	1/1/17–12/31/20	Overall	4/5/12–12/31/16	1/1/17–12/31/20	Overall
Confidential submission of Form S-1	95%	100%	97%	95%	98%	97%	87%	96%	91%	93%	98%	96%
Two years (rather than three) of audited financial statements	87%	98%	93%	37%	71%	53%	58%	84%	70%	65%	87%	76%
Omission of CD&A	100%	100%	100%	98%	99%	99%	96%	98%	97%	98%	99%	99%
Delayed application of new or revised accounting standards	10%	62%	37%	12%	71%	40%	13%	57%	33%	11%	63%	37%

With the rise of very large, well-capitalized private companies boasting valuations well in excess of $1 billion, the concept of a "direct listing" has emerged. In a direct listing, the company files a registration statement to register the resale of outstanding shares and concurrently lists its shares on a stock exchange. Under a new NYSE rule, the company may also raise primary capital in connection with a direct listing (a pending Nasdaq proposal would allow the same). Although a direct listing does not include an underwriting component, the company ordinarily retains financial advisors for assistance with aspects of the process.

REGISTRATION STATEMENT

In a direct listing, the company files a Form S-1 (or a Form F-1, for a foreign private issuer) with the SEC to register the resale of some or all of its outstanding shares under the Securities Act of 1933 and files a Form 8-A to register its common stock under the Securities Exchange Act of 1934.

The Form S-1 for a direct listing is similar to a Form S-1 for a conventional IPO, with modifications to reflect the structural differences between the two approaches, such as the plan of distribution and related matters. If the company qualifies as an "emerging growth company" (EGC), it can take advantage of the disclosure and other relief available to EGCs.

SEC FILING AND REVIEW

The Form S-1 is filed on the SEC's EDGAR system and undergoes the same SEC staff review process applicable to a conventional IPO, with additional focus on the unique aspects of a direct listing. Regardless of whether it qualifies as an EGC, the company is permitted to submit a draft Form S-1 for confidential review but must publicly file the Form S-1 (and amendments thereto) at least fifteen days before it becomes effective. Upon effectiveness of the Form S-1, stock exchange listing can be completed and trading can commence.

STOCK EXCHANGE LISTING

Nasdaq and NYSE both permit the listing of eligible securities registered under the Exchange Act without a concurrent public offering of newly issued shares, as long as applicable listing requirements are satisfied (including the filing of a resale registration statement). The overall listing process is similar to that in a traditional IPO, although aspects of the process are more difficult in the absence of a concurrent underwritten public offering and require ongoing dialogue and coordination with the exchange.

QUIET PERIOD

The SEC's quiet-period restrictions apply to a direct listing, and the safe harbors that are available in conventional IPOs are also available in direct listings. A company planning to conduct a direct listing may announce the confidential submission of a draft Form S-1 in reliance on Rule 135 and may also announce the public filing of a Form S-1 for a direct listing in reliance on Rule 134.

INVESTOR ENGAGEMENT

Although a direct listing does not include a traditional road show, a company pursuing a direct listing typically undertakes investor education activities to familiarize potential investors with the company. For example, the company may hold "test-the-waters" meetings with eligible institutional investors. An "investor day" or "non-deal" road show is also possible if conducted in accordance with SEC rules. In connection with its direct listing, Coinbase hosted an "Ask Us Anything" session on Reddit with its CEO fielding questions from everyday investors about the company's business and the cryptoeconomy (but not questions about Coinbase's anticipated stock price, future performance and the like) and posted a video on YouTube containing selected responses. Under Regulation M, investor-related activities generally cannot be conducted during a "restricted period" commencing on the fifth business day prior to the determination of the opening price and ending with the commencement of secondary market trading in the shares.

LOCKUPS

Although not commonplace in direct listings, partial lockups are sometimes implemented to facilitate a more orderly distribution of shares and to reassure public investors that management and large private investors won't sell a significant portion of their holdings soon after listing.

LIABILITY CONSIDERATIONS

There are significant unresolved questions regarding the liability framework applicable to direct listings. From the company's perspective, it is unclear whether post-listing purchasers of securities will be able to successfully assert claims under Section 11 or Section 12(a)(2) of the Securities Act for material misstatements or omissions in the registration statement. This question is the subject of ongoing litigation arising out of Slack Technologies' 2019 direct listing. It is also unclear whether financial advisors involved with direct listings might be considered "statutory underwriters," with the potential liability of underwriters under a registration statement.

RESALES

Subject to any lockup agreements, public resales of shares registered on the Form S-1 may be made as long as the Form S-1 remains effective. In many direct listings, the Form S-1 is terminated 90 days after effectiveness (at which point Rule 144 becomes available for resales by company affiliates), in order to eliminate potential liability pursuant to Section 11 or Section 12(a)(2) for further sales under the Form S-1.

Public resales of shares not registered on the Form S-1 must be made in reliance on Rule 144, which is available (subject to any lockup agreements) immediately upon Exchange Act registration for resales by non-affiliates of the company. However, Rule 144 is not available for resales by affiliates until 90 days after Exchange Act registration and may not provide sufficient liquidity for large holders due to the volume limitations under the rule.

PRIMARY CAPITAL RAISING

In December 2020, the SEC approved an NYSE rule change that permits primary capital raising in connection with a direct listing if:

— the company either sells shares having a market value of at least $100 million in the opening auction or has at least $250 million in market value of freely tradable shares at the time of listing;

— the NYSE's 400 round-lot stockholder requirement is satisfied at the time of listing without a phase-in period; and

— the company discloses the number of shares it is selling and a price range in the Form S-1, and the opening auction price is within that price range.

Nasdaq's current rules provide that a company conducting a direct listing must have a market value of publicly held shares of at least $250 million and must satisfy certain bid price and market capitalization requirements. Under a proposed rule change, which is pending as of March 31, 2021, Nasdaq would permit primary capital raising in a direct listing if these requirements are satisfied based on a price that is 20% below the bottom of the price range disclosed in the Form S-1. Under the proposal, the opening price could not be more than 20% below the bottom of the price range—providing more pricing flexibility than under NYSE's rule, which requires the opening price to be within the specified price range.

PUBLIC REPORTING

Following a direct listing, the company becomes subject to the normal public reporting and other requirements of the Exchange Act. If eligible, the company can take advantage of the reduced disclosure requirements and exemptions available to EGCs following an IPO. The company must also comply with the corporate governance requirements and other rules of the stock exchange on which its common stock is listed.

OUTLOOK

Direct listings were born out of the desire of private companies to get to the public market faster and at less cost than in a conventional IPO, without incurring the dilution of a new stock issuance. In some instances, however, the timing advantages of a direct listing are minimal and the cost of a direct listing (including financial advisory fees) can equal or exceed the cost of a conventional IPO (including underwriting discounts)—and the inclusion of a primary raise component would similarly dilute existing stockholders.

The direct listing technique remains in its infancy, with fewer than ten such listings completed to date, and none that included a primary capital raise. Nonetheless, the success of prominent examples and the substantial interest among private companies (and their venture capital backers) in the technique suggest that additional direct listings can be expected.

At this point, direct listing appears best suited to private companies that are of sufficient value and investor interest to qualify for stock exchange listing and enjoy meaningful trading liquidity without the aftermarket support provided by underwriters in a traditional IPO. Other private companies seeking an alternative path to public ownership and liquidity may find a merger with a SPAC more attractive (SPAC mergers are discussed further on pages 18–21). The extent to which the direct listing market continues to develop, the characteristics of direct listings and the companies that are able to complete them successfully, and the impact of direct listings on the conventional IPO market remain to be seen. ■

DIRECT LISTINGS: ILLUSTRATIVE METRICS AND OUTCOMES

	Asana	Coinbase Global	Palantir Technologies	Roblox	Slack Technologies	Spotify Technology	Thryv Holdings	Watford Holdings
Date	9/30/20	4/14/21	9/30/20	3/10/21	6/20/19	4/3/18	10/1/20	3/28/19
Exchange	NYSE	Nasdaq	NYSE	NYSE	NYSE	NYSE	Nasdaq	Nasdaq
Revenue	$142.6 million	$1.28 billion	$742.6 million	$923.9 million	$400.6 million	€4.09 billion	$1.42 billion	$575.2 million
Net income (loss)[1]	$(118.6 million)	$322.3 million	$(579.6 million)	$(257.7 million)	$(138.9 million)	€(1.24 billion)	$35.5 million	$(54.5 million)
First-day opening price	$27.00	$381.00	$10.00	$64.50	$38.50	$165.90	$14.00	$25.26
First-day closing price	$28.80	$328.28	$9.50	$69.50	$38.62	$149.01	$11.07	$27.00
Initial market capitalization[2]	$4.4 billion	$64.6 billion	$15.6 billion	$38.3 billion	$19.5 billion	$26.5 billion	$341.3 million	$612.4 million
Price at 3/31/21	$28.58	N/A	$23.29	$64.83	$40.63	$267.95	$23.40	$34.61
Lockup	None	None	80% of shares for 141 days	None	None	None	None	15% of shares for 180 days
Total registration expenses	$19.9 million	$45.0 million	$46.0 million	$56.0 million	$26.7 million	$45.7 million	$12.6 million	$9.1 million

[1]Most recent fiscal year prior to listing
[2]Based on first-day closing price
Source: SEC filings

Over the past 25 years, WilmerHale has handled more IPOs in the eastern United States—as issuer and underwriters' counsel—than any other law firm.

We have represented clients in more than 100 public offerings and Rule 144A placements raising almost $45 billion since the beginning of 2020, adding to a record that, over the past decade, has included more than 450 public offerings and Rule 144A placements with total proceeds in excess of $220 billion.

SCHRÖDINGER
Initial Public Offering of Common Stock
$232,300,000
and
Public Offering of Common Stock
$379,500,000
Counsel to Issuer
February and August 2020

Constellation Pharmaceuticals
Public Offering of Common Stock
$192,500,000
Counsel to Issuer
June 2020

TechTarget
Rule 144A Placement of Convertible Senior Notes
$201,250,000
Counsel to Issuer
December 2020

Oncorus
Initial Public Offering of Common Stock
$98,370,000
and
Public Offering of Common Stock
$57,000,000
Counsel to Underwriters
October 2020 and February 2021

Decibel Therapeutics
Initial Public Offering of Common Stock
$137,916,000
Counsel to Issuer
February 2021

KYMERA
Initial Public Offering of Common Stock
$200,000,000
Counsel to Underwriters
August 2020

Medtronic
Public Offering of Senior Notes
€6,250,000,000
Counsel to Issuer
September 2020

forma Therapeutics
Initial Public Offering of Common Stock
$319,294,000
and
Public Offering of Common Stock
$275,799,000
Counsel to Underwriters
June and December 2020

AKOUOS
Initial Public Offering of Common Stock
$244,375,000
Counsel to Issuer
June 2020

casella waste systems, inc.
Public Offering of Common Stock
$151,340,000
Counsel to Issuer
October 2020

ThermoFisher Scientific
Public Offerings of Senior Notes
$2,200,000,000
and
€1,200,000,000
Counsel to Issuer
March and April 2020

Translate Bio
Public Offering of Common Stock
$275,150,000
Counsel to Issuer
June 2020

ARVINAS
Public Offering of Common Stock
$460,000,000
Counsel to Issuer
December 2020

inozyme pharma
Initial Public Offering of Common Stock
$128,800,000
Counsel to Issuer
July 2020

dynatrace
Initial Public Offering of Common Stock
$655,217,000
and
Public Offerings of Common Stock
$3,880,219,000
Counsel to Underwriters
August 2019–August 2020

Discovery Communications
Public Offering of Senior Notes
$2,000,000,000
Counsel to Issuer
May 2020

Akebia Therapeutics
Public Offering of Common Stock
$151,800,000
Counsel to Issuer
May 2020

STATE STREET
Public Offerings of Notes
$3,100,000,000
and
Rule 144A Placement of Senior Notes
$1,750,000,000
Counsel to Issuer
November 2019–March 2021

Huntington Ingalls Industries
Rule 144A Placement of Senior Notes
$1,000,000,000
Counsel to Issuer
March 2020

Blue Apron
Public Offering of Common Stock
$37,000,000
Counsel to Issuer
August 2020

imara
Initial Public Offering of Common Stock
$86,480,000
Counsel to Issuer
March 2020

editas medicine
Public Offerings of Common Stock
$446,625,000
Counsel to Issuer
June 2020 and January 2021

S&P Global
Public Offering of Senior Notes
$1,300,000,000
Counsel to Issuer
August 2020

DANAHER
Public Offerings of Senior Notes
€2,500,000,000 *and*
$1,000,000,000,
Mandatory Convertible Preferred Stock
$1,717,500,000
and
Common Stock
$1,782,500,000
Counsel to Issuer
March–October 2020

Apellis
Public Offering of Common Stock
$404,225,000
Counsel to Issuer
January 2020

par
Public Offering of Common Stock
$137,409,000
Counsel to Issuer
October 2020

ANALOG DEVICES
Public Offering of Senior Notes
$400,000,000
Counsel to Issuer
April 2020

generation bio
Initial Public Offering of Common Stock
$230,000,000
and
Public Offering of Common Stock
$225,400,000
Counsel to Issuer
June 2020 and January 2021

Dyne Therapeutics
Initial Public Offering of Common Stock
$267,697,000
and
Public Offering of Common Stock
$168,000,000
Counsel to Issuer
September 2020 and January 2021

graybug
Initial Public Offering of Common Stock
$103,500,000
Counsel to Underwriters
September 2020

Ocular Therapeutix
Public Offerings of Common Stock
$224,356,000
Counsel to Issuer
May–December 2020

SOLID Biosciences
Public Offering of Common Stock
$143,750,000
Counsel to Issuer
March 2021

CURIS
Public Offerings of Common Stock
$187,125,000
Counsel to Issuer
June and December 2020

MicroStrategy
Rule 144A Placements of Convertible Senior Notes
$1,700,000,000
Counsel to Issuer
December 2020 and February 2021

AMERESCO Green • Clean • Sustainable
Public Offering of Common Stock
$161,920,000
Counsel to Issuer
March 2021

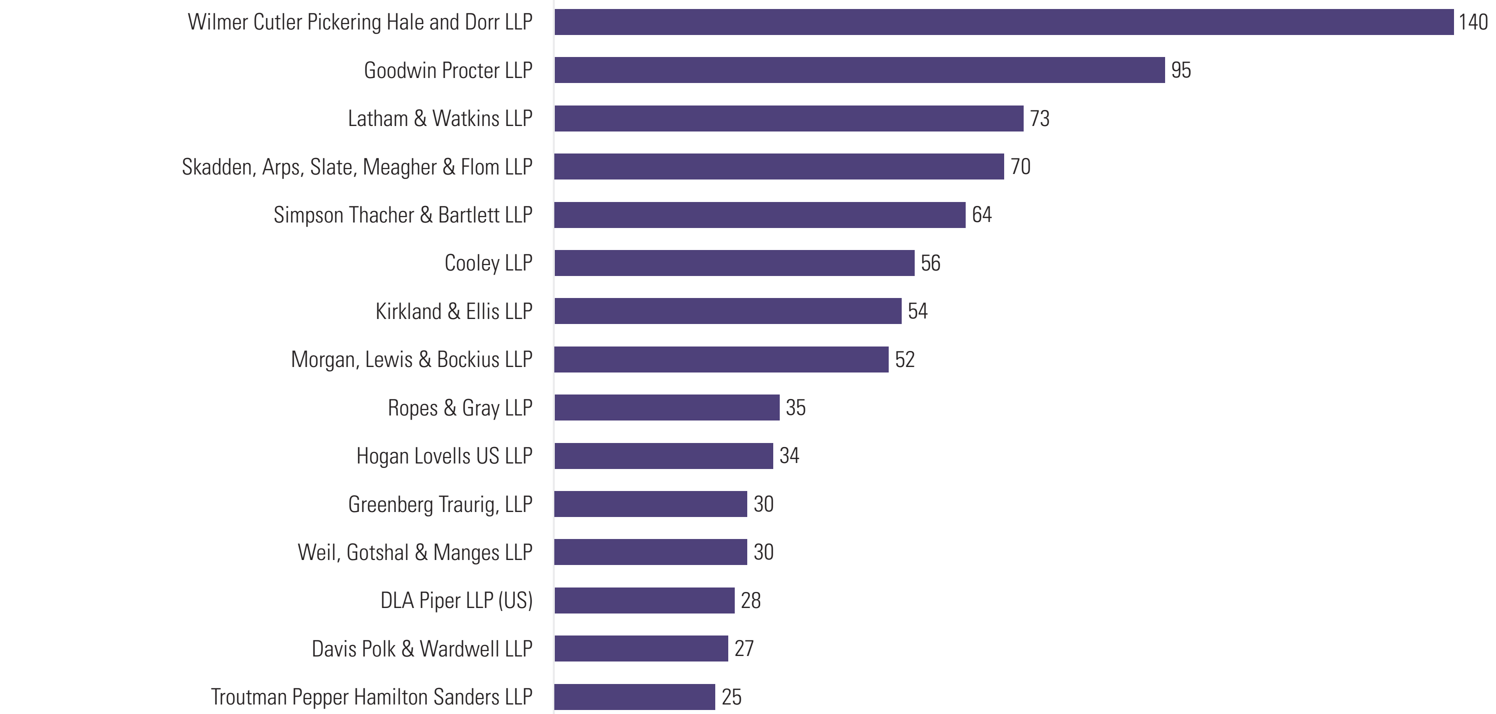
PerkinElmer For the Better
Public Offering of Senior Notes
$800,000,000
Counsel to Issuer
March 2021

ikena oncology
Initial Public Offering of Common Stock
$143,750,000
Counsel to Underwriters
March 2021

PANDION Therapeutics
Initial Public Offering of Common Stock
$152,895,000
Counsel to Issuer
July 2020

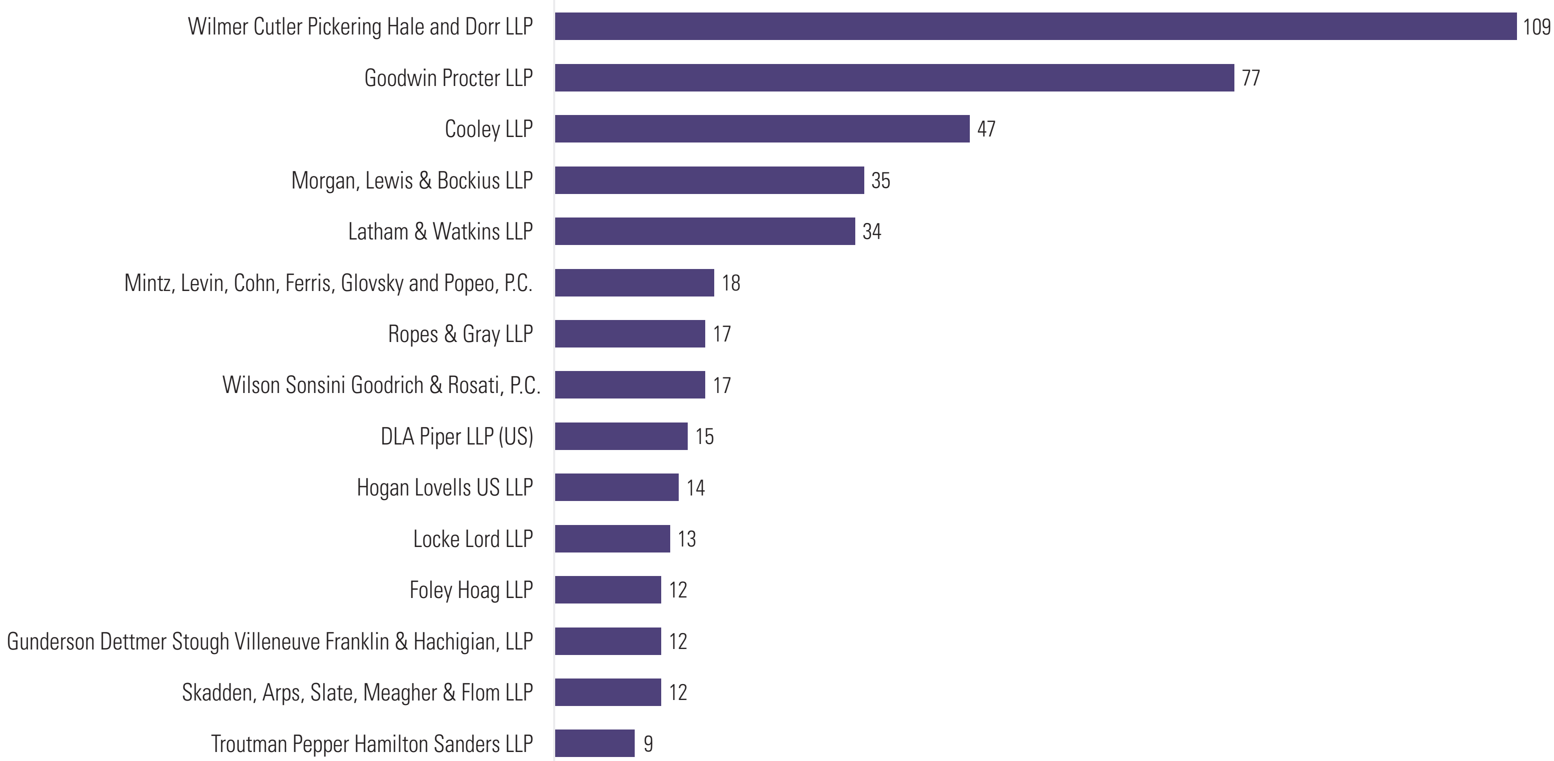
WILMERHALE®

Company Counsel in Eastern US IPOs – 1996 to 2020



Source: SEC filings

Company Counsel in Eastern US VC-Backed IPOs – 1996 to 2020

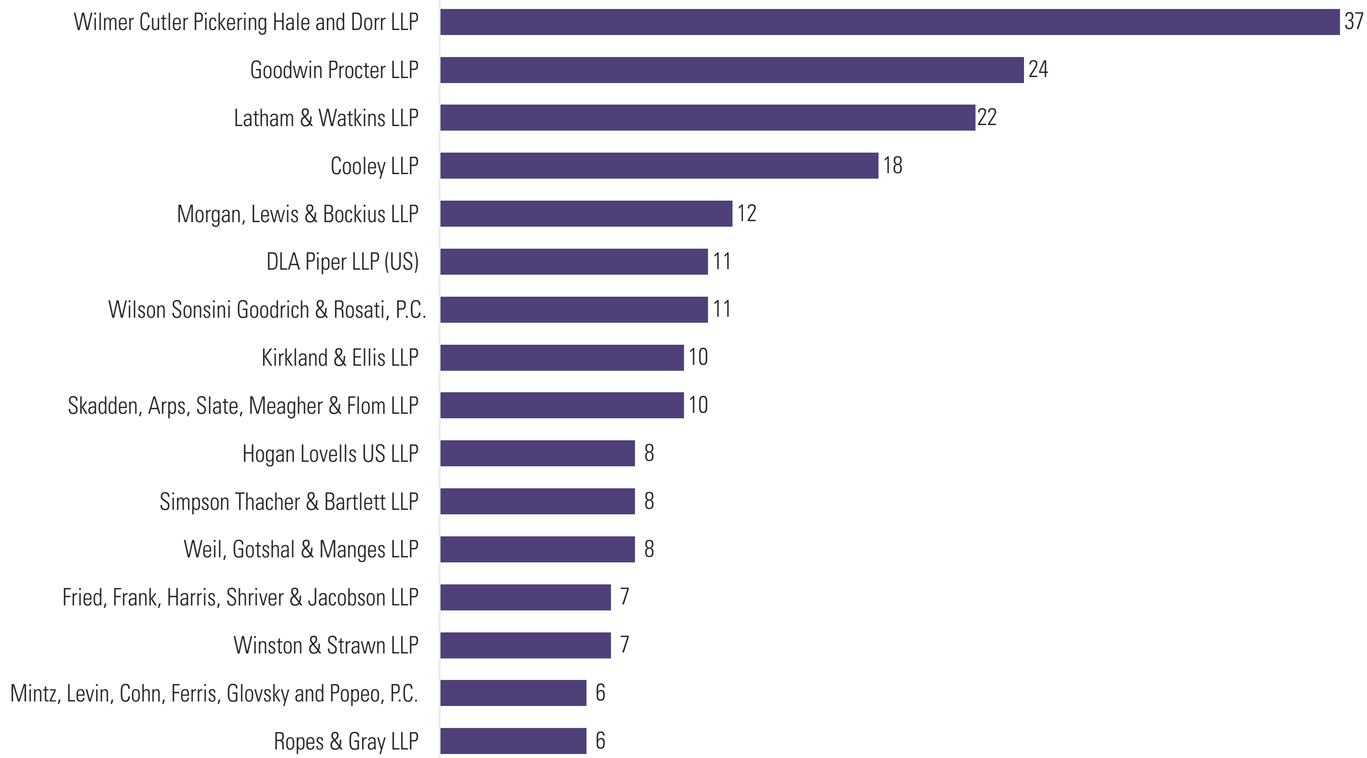


Source: SEC filings

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

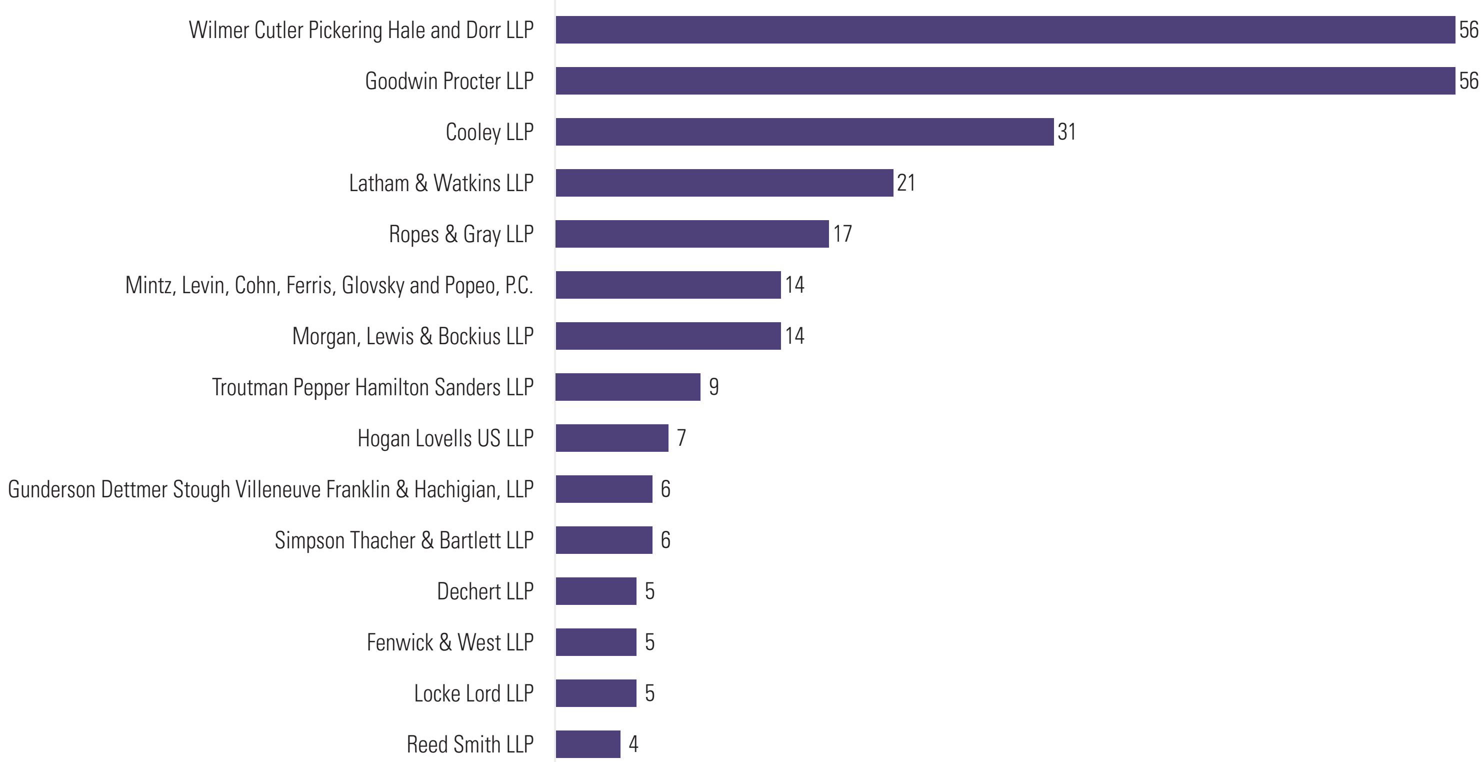
Law Firm Rankings

Company Counsel in IPOs of Eastern US Technology Companies – 2000 to 2020



Source: SEC filings

Company Counsel in IPOs of Eastern US Life Sciences Companies – 2000 to 2020



Source: SEC filings

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

SPACs, or special purpose acquisition companies, took the capital markets by storm in 2020. While SPAC IPO activity had been increasing for the last several years, the volume and proceeds in 2020 was entirely unprecedented, greatly exceeding prior levels. And the first quarter of 2021 was even more frenetic. SEC filings show that 248 SPAC IPOs, with $75.7 million in total proceeds, were completed in the United States in 2020, compared to 209 conventional IPOs raising $76.3 billion. Between January 1 and March 31, 2021, 298 SPAC IPOs raised $87.01 billion in total proceeds—more than the totals for all of 2020—compared to 97 conventional IPOs raising $38.81 billion.

According to spactrack.net, 64 SPAC business combinations were closed in 2020 and another 24 were completed in the first quarter of 2021. As of March 31, 2021, spactrack.net reported that 120 SPACs were party to definitive business combination agreements and that another 431 SPACs, with aggregate proceeds in trust of $139.0 billion, were seeking business combination targets. Industry sectors seeing significant SPAC activity include technology, fintech, healthcare, media, telecom, sports and entertainment, aerospace and aviation, energy, sustainability and cannabis.

Although the pace of new SPAC IPOs began to slow in April of 2021, the number of SPACs currently searching for targets and the profusion of SPAC IPOs over the past year suggest that SPACs should remain a significant driver of capital markets and M&A activity, barring a setback that causes them to fall from favor.

SPAC SIMILARITIES TO AN IPO

A SPAC business combination bears many similarities to a conventional IPO.

- A private company going public through a SPAC transaction must be public company–ready.
- Public company readiness and housekeeping measures are essentially the same.
- Both structures require a very substantial time commitment from management, and other company resources.
- The SEC review process for the Form S-4 (merger proxy statement/prospectus) in a SPAC transaction is similar to the SEC review process for the Form S-1 in an IPO.
- Company-related disclosures in the Form S-4 are very similar to Form S-1 disclosures.
- The due diligence process is very similar.
- Upon completion of the SPAC transaction, the combined company must meet stock exchange listing requirements.
- The overall timeline to complete a SPAC transaction is generally comparable to that of a traditional IPO.

WHAT IS A SPAC?

A SPAC is a "blank check" company that is formed for the purpose of engaging in a merger or other business combination with one or more operating businesses. SPAC sponsors typically have significant investing, financial and/or operating experience, with deep knowledge and contacts in a target industry. SPACs raise capital in an IPO, typically by selling units composed of shares and warrants. The proceeds raised in the IPO are held in trust, to be used for an initial business combination. SPACs typically have 24 months to complete their initial business combination.

SPAC sponsors typically receive a 20% equity stake in the SPAC at a nominal cost. This equity stake is in the form of "founder shares," also known as the sponsor's "promote." In addition, the sponsor typically invests "at risk" capital, most commonly in the form of warrants (although the "at risk" capital can also be in the form of common stock or units). The "at risk" capital, which often has a value approximating 3% of the SPAC's IPO size, is used to help cover transaction costs and provide the combined company with working capital. Some recent SPACs have used different sponsor promote structures to better align sponsor and stockholder interests and to make themselves more attractive to potential target companies.

The proceeds from a SPAC IPO are deposited into a trust account. The funds are released upon completion of the SPAC's initial business combination. If the SPAC is unable to complete a business combination within its 24-month or other allotted time frame, the SPAC liquidates and returns the proceeds held in trust to stockholders.

SPAC IPO investors typically pay $10.00 for the units sold in the IPO. While there are exceptions, warrant coverage in a SPAC IPO typically ranges between one-quarter to one-half of a warrant per share of common stock offered (with one-third of a warrant being very common). Some recent SPAC IPOs have offered only common stock without warrants. Where units are offered, the units typically "separate" 52 days after the IPO closing, unless the underwriters permit earlier separate trading and certain other conditions are satisfied.

A SPAC's warrants typically have a strike price of $11.50 per share, become exercisable upon the later of 30 days following completion of the SPAC's initial business combination and one year after the SPAC's IPO, and generally expire five years after the initial business combination. The warrants typically provide that they can be redeemed any time after they become exercisable if the SPAC's stock trades at or above $18.00 per share for a specified period, and in many cases the SPAC may redeem the warrants after they become exercisable if the SPAC's stock is trading at or above $10.00 per share.

Typically, the underwriting discount for a SPAC IPO is 5.5%, of which 2.0% is received by the underwriters at the time of the IPO and the remaining 3.5% is deferred until the SPAC completes its initial business combination. If the SPAC does not complete a business combination, the underwriters forfeit the deferred underwriting fee.

REDEMPTION AND APPROVAL RIGHTS

In connection with a SPAC's initial business combination, a SPAC's public stockholders have the right to redeem their shares for the pro rata per share amount of proceeds in the SPAC's trust account. The redemption amount typically equates to approximately $10.00 per share plus accumulated interest on the funds in trust (or roughly the same amount paid for the SPAC's units in the IPO, plus interest). Parties to a SPAC transaction make a concerted effort to minimize the level of stockholder redemptions, as significant redemptions can deplete the amount of funds that become available to fund the combined company's operations following completion of the business combination. The target typically negotiates for the right to terminate the business combination agreement if it does not receive a minimum amount of cash proceeds at closing, after giving effect to redemptions and deal expenses.

The level of stockholder redemptions in connection with a SPAC business combination is often a function of how well the proposed transaction is received in the marketplace. The higher the SPAC's stock price trades relative to the redemption price, the lower redemptions would be expected to be (because an investor who does not want to remain an investor in the combined company could sell its shares for a higher price in the market). Warrants are not subject to investor redemption rights—investors can retain their warrants whether or not their shares are redeemed. The SPAC sponsor's shares (including any shares the sponsor may have acquired in the IPO or public market) typically are not subject to redemption in connection with the initial business combination.

In addition to redemption rights, the SPAC's stockholders typically have the right to approve the transaction at a stockholder meeting. While a SPAC business combination could in some cases be structured so as to not require a vote by the SPAC's stockholders, SPACs generally seek stockholder approval. A SPAC stockholder can vote for or against a business combination and, regardless of the vote, exercise its redemption right and keep any warrants it holds. The SPAC's sponsor is entitled to vote with the public stockholders on the initial business combination, with the sponsor's founder shares representing a large portion of the votes needed for approval. As a result, SPACs generally have had little difficulty in obtaining stockholder approval for their business combinations (although there have been several instances where a SPAC has had to adjourn or postpone a stockholder meeting in order to get to a quorum). If a SPAC holds a stockholder meeting to approve its initial business combination, the redemption process is conducted in conjunction with the meeting and redemption rights must typically be exercised no later than two business days before the vote. If no stockholder vote is held, redemption rights must be provided through a tender offer.

PIPE FINANCINGS

In most cases, a SPAC arranges for PIPE (private investment in public equity) financing in connection with its initial business combination. The PIPE capital helps offset redemptions and provides operating capital following completion of the business combination. The participation of well-known investors in the PIPE can also help validate the target and the proposed business combination, including its valuation, and mitigate deal certainty risk. PIPEs have become a very significant component of the SPAC business combination process, and in many cases the amount of capital raised in the PIPE equals or exceeds the amount of capital in the SPAC's trust account from its IPO. In some cases, a SPAC's sponsor or an affiliated entity may enter into a forward purchase commitment at the time of the SPAC's IPO in order to demonstrate committed additional capital in connection with the initial business combination.

SPAC sponsors typically agree to vote their shares in favor of, and not to redeem any SPAC stock owned by them in connection with, the initial business combination. In addition, SPAC sponsors typically agree not to transfer their founder shares for 12 months following completion of the initial business combination, subject to early release if certain share price targets are reached (generally beginning 150 days after the closing of

SPAC DIFFERENCES FROM AN IPO

Notwithstanding the similarities to a conventional IPO, SPAC business combinations also differ from IPOs in many important respects.

- Key structural differences include:
  - the manner in which valuation is set (bilateral agreement vs. bookbuilding process);
  - flexibility in transaction structuring (including the ability to incorporate cash consideration and earnout type structures);
  - investor engagement (PIPE and "de-SPACing" process vs. "test-the-waters" and road show);
  - the stockholder approval and redemption process in a SPAC transaction;
  - the dilutive impact of the sponsor's founder shares and "at risk" capital; and
  - public warrant overhang.
- Instead of a Form S-1, the principal SEC disclosure document is a merger proxy statement/prospectus on Form S-4 (or sometimes just a merger proxy statement).
- The Form S-4 includes extensive transaction-related disclosures.
- Form S-4 work is typically split between the SPAC and its counsel (primarily responsible for transaction-related disclosures) and the target and its counsel and auditors (primarily responsible for target disclosures).
- Other key disclosure documents include an investor presentation used to market the PIPE (made publicly available when the deal is signed and publicly announced) and a "Super 8-K" filed following the closing of the transaction.
- Communications in a SPAC transaction are governed by the M&A and proxy rules, allowing some greater latitude than the IPO communications rules (but still subject to anti-fraud liability and significant SEC filing obligations).
- Projections are commonly used to market a SPAC transaction, whereas in an IPO the company may review and discuss its operating model with underwriters and research analysts but does not make its model or projections public.
- The parties may engage an investor relations firm to coordinate on public communications and research analyst coverage strategies.
- Governance, corporate and capital structure determinations (such as management team, board composition, corporate and capital structure) are made jointly with the SPAC.
- The target and its advisors undertake due diligence on the SPAC.
- Depending on the transaction's complexity, legal and accounting expenses for a SPAC transaction can be higher than for a traditional IPO.

the initial business combination). In addition, sponsors typically agree not to transfer their warrants until at least 30 days following completion of the SPAC's initial business combination.

GOING PUBLIC THROUGH A SPAC BUSINESS COMBINATION

From the perspective of the target, a SPAC business combination represents an alternative way to go public. By engaging in a business combination with a SPAC, many private companies have been able to raise substantial amounts of capital and become public companies at a much earlier stage in their life cycles than has historically been the case.

From a transaction execution standpoint, a SPAC business combination combines elements of a public company M&A transaction and an IPO. A private company combines with the SPAC in a merger or other business combination transaction. In most cases, the target's stockholders own a majority of the combined company's shares following completion of the transaction.

A HIGH-LEVEL OVERVIEW OF THE SPAC TRANSACTION PROCESS

A SPAC transaction combines elements of an IPO process with a public M&A process and a PIPE financing. A typical SPAC business combination transaction entails:

— identification by a SPAC of an appropriate private company target, and vice versa;

— negotiation of a letter of intent;

— due diligence by the SPAC on the target, and vice versa;

— negotiation of a merger agreement and other definitive documentation between the SPAC and the target;

— a PIPE financing;

— preparation and SEC review of a S-4 registration statement that includes a prospectus and merger proxy statement (or, in some cases, just a merger proxy statement and no registration statement);

— a stockholder vote and redemption process; and

— in conjunction with the above, preparations to become a public company.

In some cases, a SPAC may complete its initial business combination with two or more targets, although these transactions are less common and entail significant additional complexity and expense.

POTENTIAL ADVANTAGES OF A SPAC TRANSACTION

There are many reasons for a private company to consider going public through a SPAC business combination. These include:

— ***Attractive Valuation and Capital Availability.*** A SPAC transaction offers the potential for a higher valuation pricing than an IPO (although this obviously is situation-dependent). In addition, the amount of capital made available to a target through a SPAC business combination may significantly exceed the amount the company could raise in a private financing or IPO.

— ***Upfront Pricing.*** In a SPAC business combination, valuation is set at the front end of the process through negotiation with the SPAC sponsor (rather than on the back end following the underwriters' bookbuilding process). Note, however, that the valuation agreed to with the sponsor also needs to be accepted by the PIPE investors (where applicable) and ultimately by the public markets.

— ***Flexible Structuring.*** A SPAC transaction offers significant flexibility in structuring transaction consideration. Equity can be rolled from the target into the SPAC (which is most commonly the case), but investors can be cashed out, the transaction can provide for a combination of consideration, and the deal structure can incorporate the use of earnouts, among other things.

— ***Communications Flexibility.*** The SPAC process offers a somewhat more flexible communications regime and permits greater investor engagement as compared to the traditional IPO process, including through the use of projections and forward-looking information (although still subject to anti-fraud liability and the M&A and proxy filing/disclosure regime).

— ***Shorter Time to Public Market.*** The use of a PIPE can effectively collapse a crossover round with an IPO, potentially saving time in going public when the company needs to complete an interim financing.

— ***Quality Sponsors.*** A SPAC transaction offers the opportunity to partner with quality sponsors, which may be particularly attractive for founder-backed companies or other companies that don't have a substantial institutional investor base. In a typical SPAC business combination, the target's existing management team remains in place, while the sponsor typically receives board seats and has a continuing meaningful equity stake in the combined company.

— ***Exit Option.*** For PE or VC portfolio companies, founder-backed companies or companies that may not have been viewed as good fits for a traditional IPO, a SPAC can provide another avenue for exit.

— ***Favorable Deal Terms.*** The large number of SPACs currently seeking targets may result in an opportunity to negotiate more favorable deal terms. As a SPAC approaches its 24-month or other applicable deadline to complete a business combination, a target may have even greater leverage to negotiate favorable terms.

OTHER CONSIDERATIONS

— ***Expense.*** A SPAC transaction is not necessarily cheaper, and can be more expensive, than an IPO, after factoring in the sponsor's founder shares and fees from transaction advisors. Generally, companies should assume that all-in SPAC transaction costs will be roughly comparable to, or possibly higher than, those of an IPO.

— ***Timeline.*** A SPAC transaction is not necessarily a quicker pathway to going public. While a SPAC transaction may allow a company to go public earlier in its life cycle than might otherwise be the case, the actual time to complete a SPAC transaction is likely to be roughly comparable to an IPO timeline.

— ***Sponsor Dilution.*** The sponsor's founder shares and "at risk capital" are dilutive to other stockholders. However, the sponsor's retention of its founder shares and "at risk" capital is often negotiable and the sponsor may be willing to subject some of it to vesting based on post-deal stock performance.

— ***Warrant Overhang.*** The warrant overhang and potential future dilution from warrant exercises affects valuation and structuring of a deal.

— ***Public Company Readiness.*** A private company going public through a SPAC business combination needs to be public company–ready, just as it would need to be in an IPO, including having SEC/PCAOB–compliant financial statements and otherwise being ready to operate as a public company by the time its business combination is completed. The ability to satisfy SEC reporting requirements and comply with public company governance, disclosure and stock exchange listing requirements are all equally applicable in the case of a SPAC transaction.

— ***Shell Company Restrictions.*** As a former "shell company," the combined company is subject to certain limitations that are not applicable to a company that goes public through an IPO. This includes the inability to use Rule 144 for at least one year following the business combination, ineligibility to use Form S-8 until 60 days post-business combination, a requirement to wait 12 months post-business combination before using a short-form registration statement on Form S-3, the inability to use free writing prospectuses (including electronic roadshows) or to become a WKSI for three years, and certain other limitations.

— ***Substantial Effort.*** Just like an IPO or a regular M&A transaction, going public through a SPAC involves a significant amount of time and expense. It's not a shortcut, and the target's management team needs to devote a significant amount of their time to ensuring the success of the transaction.

— ***Research Coverage.*** More effort may be required to attract research coverage than in an IPO. A SPAC and its target should have a well-thought-out investor relations plan that includes not only investor engagement but also research coverage. Financial advisors whose sell-side analysts are likely to cover the combined company can assist in this effort.

— ***Redemption Risk.*** The redemption rights of the SPAC's stockholders pose a potentially significant risk to deal certainty. This risk can be significantly mitigated if the SPAC obtains capital from a PIPE and/or forward purchase or other financing commitments and if the business combination agreement includes a "minimum cash" condition.

— ***Risk of Failed Transaction.*** Not every proposed SPAC combination that gets to the letter of intent stage results in a definitive agreement, nor is every announced transaction completed. A deal that is not well received in the marketplace may face significant redemptions and difficulties in being completed, particularly if PIPE or other financing commitments are not in place to backstop redemption risk.

— ***Lack of Recourse Against SPAC.*** Business combination agreements typically include the target's waiver of the right to make claims against the SPAC trust and do not provide for break-up and termination fees from the SPAC. As a result, the target may not have meaningful financial recourse against the SPAC for breaches, although the target may be able to negotiate with the SPAC's sponsor or an affiliated party for partial expense reimbursement in the event of a busted deal.

— ***Lockups.*** The SPAC's sponsor and other insiders typically are subject to a one-year post-business combination lockup from the SPAC's IPO (subject to early release based on the SPAC's trading price). Insiders and large stockholders of the target are expected to agree to a lockup of a negotiated duration (which may parallel the lockup of the SPAC's sponsor and insiders, or be different).

— ***Risk of Stock Price Decline.*** In many cases the stock price of the combined company declines following completion of the business combination. Among other reasons, the price floor provided by the SPAC's stockholder redemption right no longer exists; the combined company will be valued based on the performance of its business; and sales by PIPE and other investors may create pricing pressure.

— ***Rotation of Stockholder Base.*** Many SPAC IPO investors are not long-term investors. As a result, a lot of effort often is required to ensure that the SPAC's stock moves into the hands of long-term fundamental investors and other investors who do not intend to redeem their shares in connection with the business combination.

— ***Increasing Risk.*** Litigation involving SPAC business combinations is on the rise, particularly when post-combination operations falter, and the SEC is increasingly turning its focus towards SPACs. Due to the perceived increase in litigation risk, premiums for D&O insurance have risen dramatically in the SPAC area.

LOOKING AHEAD

SPACs have established themselves as a formidable alternative to a conventional IPO. The long-term staying power of SPACs will depend on many factors, including the performance of the combined companies resulting from SPAC transactions. While it is inevitable that not all SPAC deals will turn out well (just as not all companies going public through an IPO perform well), avoidance of high-profile failures and instances of fraud or misconduct will be critical to maintain investor confidence in the SPAC market. Macroeconomic factors, investor concerns over increasing risk, and adverse regulatory developments could also dampen enthusiasm for SPACs.

However, at least for the near term, SPACs are expected to remain an attractive alternative to a conventional IPO. Any private company evaluating its exit options would be remiss not to consider a SPAC transaction. ■

Although an insider trading policy is not technically required, every company going public should adopt one. An insider trading policy is intended to help:

- prevent violations of the insider trading laws;
- avoid embarrassing proxy disclosure of reporting violations by persons subject to Section 16 of the Securities Exchange Act of 1934;
- avoid the appearance of impropriety on the part of those employed by or associated with the company;
- minimize the company's risk of incurring "controlling person liability" for insider trading violations by directors, officers and employees; and
- protect the reputations of the company, its directors and its employees.

Each company must select the package of policy provisions that reflects its own circumstances, achieves its policy goals, and is workable.

KEY ELEMENTS

The key elements of a typical insider trading policy are:

- prohibitions, rooted in the federal securities laws, against trading in the company's securities while aware of material nonpublic information concerning the company and "tipping" such information to others;
- prohibitions on trading in the company's securities during designated "blackout" periods, regardless of whether a person is actually aware of material nonpublic information;
- prohibitions on short sales of company securities and on purchases or sales of puts, calls or other derivative securities based on the company's securities, and other limitations on pledging or hedging of the company's securities;
- requirements to pre-clear proposed transactions in company securities with a designated company representative and, for Section 16 reporting persons, to promptly report completed transactions to the company representative; and
- the company's commitment to providing ongoing education and assistance regarding compliance with the policy and insider trading laws.

In congressional correspondence and testimony in late 2020, then–SEC Chair Jay Clayton emphasized the importance of "good corporate hygiene," including controls designed not only to prevent insider trading, but also to avoid the appearance of impropriety. Clayton stated that, in his view, a well-designed insider trading policy should have controls in place to prevent senior executives and directors from trading once a company is in possession of material nonpublic information, even if an officer or director does not personally have knowledge of the information.

BLACKOUT PERIODS

As part of their insider trading policies, virtually all public companies establish blackout periods in order to prevent transactions from taking place during periods when there is a high risk that someone is aware of material nonpublic information. Companies generally have regularly scheduled quarterly blackout periods that commence at some point during the final month of each fiscal quarter and end one or two trading days after the company has publicly announced its earnings for the quarter. Some companies extend the end of their quarterly blackout period until one or two trading days after the applicable periodic report is filed with the SEC. Pre-commercial life sciences companies often use a shorter blackout period in light of the immateriality of quarterly financial results.

Companies typically reserve the right to impose special blackout periods in connection with potential or pending corporate developments (such as merger discussions or the investigation of a cybersecurity incident) that may constitute material nonpublic information. In addition, certain trades by directors and executive officers typically are precluded during any "pension fund blackout period" imposed by Regulation BTR if the company has a 401(k) plan that permits investments in company stock.

All directors, officers, employees, family members and controlled entities are subject to the prohibitions on trading in the company's securities while aware of material nonpublic information concerning the company and on "tipping" such information to others, given that those restrictions are required by law. The company must, however, determine the universe of employees who will be subject to the regularly scheduled quarterly blackout periods, as those periods are not mandated by law.

Companies that have a relatively small number of employees or that have a corporate culture of broadly sharing information often apply these blackout periods to all employees. Many young public companies adopt this approach, particularly if they have only one principal facility and their employees have fairly open access to company information. More established companies with large numbers of employees, multiple facilities and more restricted access to sensitive information typically apply blackout periods only to designated employees, such as management, finance, accounting and legal staff. Similarly, the company must decide which employees will be subject to the other provisions of the policy.

OTHER POLICY CHOICES

Crafting a suitable insider trading policy also requires the company to make additional decisions, which means answering questions such as the following:

- ***Blackout or Window Periods:*** What time period will be covered by the company's regular quarterly blackouts? Alternatively, should the company adopt a more restrictive "window" approach that permits insider transactions only during a short period following public disclosure of information about the most recently completed fiscal period (assuming a special blackout period is not in effect)?
- ***Treatment of Equity Grants:*** On what conditions may stock options be exercised

during blackout periods? May an option be exercised if it is not otherwise going to expire? How will tax withholding obligations be satisfied upon option exercises, vesting of restricted stock and settlement of restricted stock units?

— ***Rule 10b5-1 Trading Plans:*** May purchases and sales be made during blackout periods pursuant to Rule 10b5-1 trading plans? Will the company encourage—or perhaps mandate—that all market purchases and sales by directors and officers be effected only pursuant to Rule 10b5-1 trading plans? Will the company specify minimum requirements for Rule 10b5-1 trading plans that go beyond what is technically required by the rule, such as a minimum waiting period between when a plan is adopted and sales under the plan may begin? (Rule 10b5-1 trading plans are discussed further on pages 24–26.)

— ***Gifts and Charitable Donations:*** Will gifts and charitable donations be restricted in the same manner as purchases and sales? Will any restrictions be imposed on the recipients of these shares?

— ***Stock Pledges and Loans:*** Will the policy restrict the use of company securities as collateral for loans (including securities in margin accounts) and the purchase of company securities using borrowed funds?

— ***Hedging Company Securities:*** Will the policy limit the ability of employees and directors to hedge against losses in value of company securities they hold? Available hedging techniques include prepaid variable forward contracts, equity swaps, collars and exchange funds. An SEC rule adopted pursuant to the Dodd-Frank Act requires proxy disclosure of any practices or policies a company has adopted regarding the ability of employees or directors to purchase financial instruments or otherwise engage in transactions that hedge or offset any decrease in market value of company securities, including those of any parent, subsidiary or sister company.

— ***Application to Controlled or Affiliated Entities:*** How will the policy apply to entities controlled by the company's directors, officers and employees? How will the policy apply to transactions in company securities by a venture capital or private equity fund that has an affiliate on the board of directors, including distributions to the fund's partners? One approach is to apply the company's insider trading policy unless the controlled or affiliated entity has implemented appropriate policies and procedures to prevent the insider from influencing trades by the entity.

MARKET PRACTICES

The Domestic Stock Plan Administration Surveys co-sponsored by the National Association of Stock Plan Professionals and Deloitte Consulting LLP elicit information on the insider trading compliance practices of public companies of various sizes and across industries. Based on the three most recent surveys, conducted in 2014, 2017 and 2020, the accompanying tables set forth the categories of persons to whom regularly scheduled quarterly blackout periods are applied and the types of transactions that are prohibited during these blackout periods (unless executed pursuant to a Rule 10b5-1 trading plan). In addition, public companies typically:

— prohibit hedging and pledging of company stock;

— prohibit trading in puts, calls or similar derivatives of company stock;

— require insiders to pre-clear all stock transactions, including option exercises (with clearance most often provided by the general counsel); and

— prohibit open market purchases and sales during blackout periods (except pursuant to Rule 10b5-1 trading plans). ■

PERSONS SUBJECT TO REGULARLY SCHEDULED QUARTERLY BLACKOUT PERIODS

CATEGORY	2014 SURVEY	2017 SURVEY	2020 SURVEY
Section 16 insiders	96%	96%	98%
Other senior management	93%	92%	94%
Middle management	65%	64%	61%
Other exempt employees	51%	49%	47%
Employees with access to financial or material nonpublic information	91%	91%	90%
Non-exempt (hourly) employees	39%	39%	35%
Outside directors	95%	91%	93%
Contractors, consultants and temporary employees	35%	32%	31%

TRANSACTIONS PROHIBITED DURING REGULARLY SCHEDULED QUARTERLY BLACKOUT PERIODS

CATEGORY	2014 SURVEY	2017 SURVEY	2020 SURVEY
Broker-assisted cashless option exercises	90%	89%	84%
Stock-for-stock option exercises	61%	63%	62%
Share withholding upon option exercises	58%	54%	50%
Cash option exercises	50%	55%	51%
Share withholding upon restricted stock/RSU awards	35%	36%	32%
Gifts	38%	40%	45%

Source: Domestic Stock Plan Administration Surveys, 2014, 2017 and 2020 (co-sponsored by the National Association of Stock Plan Professionals and Deloitte Consulting LLP)

Rule 10b-5 under the Securities Exchange Act of 1934 prohibits fraudulent statements or actions in connection with the purchase or sale of securities. The practical effect of Rule 10b-5 is to prohibit any insider with material nonpublic information about the company from buying or selling the company's securities until the company has publicly disclosed the information and the market has had an opportunity to absorb it. The result is that executives of public companies have limited opportunities to buy or sell company stock.

Violations of Rule 10b-5 can result in administrative, civil or criminal penalties and may also be the subject of private lawsuits. Any of these consequences, or even an SEC investigation that does not result in a formal proceeding or prosecution, can also tarnish an executive's reputation and cause irreparable career damage, including a temporary or permanent bar from serving as an officer or director of any public company. The SEC and federal prosecutors vigorously pursue alleged violations of the insider trading laws, even in cases where the amounts involved are small.

WHAT IS MATERIAL NONPUBLIC INFORMATION?

Information is "nonpublic" if it has not been disseminated in a manner making it available to investors generally.

In general, courts have held that information is "material" if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision with respect to the company's securities. Stated another way, there must be a substantial likelihood that a reasonable investor would view the information as having significantly altered the "total mix" of information available about the company.

Material information can include positive or negative information about the company. Prospective developments, such as a possible acquisition, can be material if the anticipated magnitude of the event, discounted by the likelihood of its occurrence, is something that a reasonable investor would consider important. Determining whether information is material requires consideration of both quantitative and qualitative factors.

SEC rules provide some relief to executives facing this quandary. Rule 10b5-1 can help protect a person from Rule 10b-5 liability for trading while aware of material nonpublic information concerning the company if the purchase or sale was made pursuant to a binding contract, specific instruction or written plan—a "Rule 10b5-1 trading plan"—that the person put into place while unaware of material nonpublic information. Despite increasing scrutiny, a properly established Rule 10b5-1 trading plan remains a valid and important tool for executives.

PLAN REQUIREMENTS

Rule 10b5-1 trading plans generally must specify the number of shares to be purchased or sold, the timing of the transactions, and the price or prices at which the trades will be effected. These variables may be expressed as specific numbers, dates and dollar amounts, or described in ranges or formulas that are automatically applied. Rule 10b5-1 trading plans may be used for either purchases or sales, but when used by executives typically cover sales. Rule 10b5-1 is also available for company transactions, and companies often rely on the rule to structure open market stock repurchases.

In order to rely on the rule, a person must enter into the Rule 10b5-1 trading plan in good faith and not with the intention of evading insider trading prohibitions, and must carry out the trading activity in accordance with the specifications of the plan. If a person deviates from or alters the plan while in possession of material nonpublic information, the defense will not be available for subsequent trades under that plan and the defense may even be retroactively lost for prior trades under the plan. Amendment of, or deviation from, a Rule 10b5-1 trading plan may make it difficult for an insider to demonstrate that he or she has satisfied the rule's good-faith requirement. Although a person may change the specifications of a Rule 10b5-1 trading plan during a time in which he or she does not possess material nonpublic information, the person will lose the defense if he or she enters into a corresponding or hedging transaction that has the effect of offsetting a trade made in accordance with the plan.

The SEC's guidance on Rule 10b5-1 trading plans emphasizes that termination of a plan, or cancellation of one or more plan transactions, could affect the availability of the defense for prior plan transactions if it calls into question whether the rule's good-faith requirement was satisfied.

PROS AND CONS OF RULE 10b5-1 TRADING PLANS

Benefits

- A Rule 10b5-1 trading plan provides an insider with an opportunity to diversify his or her holdings in the confidence that he or she will not violate federal insider trading rules, even if the insider is aware of material nonpublic information at the time a trade is executed under the plan.
- If publicly disclosed, a Rule 10b5-1 trading plan could deflect adverse investor and media reaction to transactions that may otherwise suggest that an insider took advantage of material nonpublic information. When applicable, it is common practice to indicate in Section 16 filings that reported transactions were made pursuant to a Rule 10b5-1 trading plan (a pending SEC proposal would amend Forms 4 and 5 to add an optional check box to indicate that a transaction was intended to satisfy Rule 10b5-1).
- Prior public announcement of a Rule 10b5-1 trading plan could reduce the likelihood of a company becoming the target of stockholder litigation, since allegations of insider trading are frequently an element of class-action securities litigation.

Drawbacks

- The insider loses some investment control over the trading activity.
- If public disclosure of a Rule 10b5-1 trading plan is made, any failure of the insider to sell in accordance with the plan could raise questions in the market.
- Trading under a Rule 10b5-1 trading plan does not eliminate the possibility that insider trading could be alleged. If sued, the insider has the burden of proving that he or she sold pursuant to a plan established under Rule 10b5-1.
- Sales by directors, officers and 10% stockholders under a Rule 10b5-1 trading plan are not exempt from matching liability under Section 16.

The guidance also clarifies that the defense is not available if a person establishes a Rule 10b5-1 trading plan while aware of material nonpublic information, even if the plan is structured so that plan transactions will not begin until after the material nonpublic information is made public.

INCREASING SCRUTINY

Because of the potential for abuse, Rule 10b5-1 trading plans have long been scrutinized by the SEC, courts and institutional investors. Rule 10b5-1 trading plans have also been questioned in the past by academic researchers finding a statistical correlation between the timing of executive sales under these plans and the release of negative corporate news.

Scrutiny of Rule 10b5-1 trading plans has recently increased on various fronts:

— ***Public Criticism:*** Rule 10b5-1 trading plans have drawn an increasing amount of public attention. For example, disclosure of stock sales by executives of pharmaceutical companies developing COVID-19 vaccines attracted widespread media attention and public criticism in the fall of 2020—much of the criticism failing to understand the significance of the sales having been made under Rule 10b5-1 trading plans and how the plans work.

— ***SEC Chair Commentary:*** In congressional correspondence and testimony about "good corporate hygiene" in late 2020, then–SEC Chair Jay Clayton stated his belief that companies should strongly consider requiring all Rule 10b5-1 trading plans for senior executives and board members to include mandatory waiting periods after adoption, amendment or termination before trading under the plan may begin or recommence. He informally suggested a minimum "cooling-off" period of four to six months and observed that waiting periods help demonstrate that a plan was executed in good faith and can bolster investor confidence in management teams and in markets generally.

— ***Stanford Study:*** In January 2021, the Rock Center for Corporate Governance at Stanford University released a study on the trading behavior of corporate executives, using data from over 20,000 Rule 10b5-1 trading plans, including associated plan adoption dates and trades. The study identified three "red flags"—plans with a short cooling-off period; plans that entail only a single trade; and plans adopted in a given quarter that begin trading before that quarter's earnings announcement—associated with "opportunistic" selling of company shares in advance of stock price declines to avoid significant losses, and made several recommendations to address plan abuses.

— ***Glass Lewis Best Practices:*** Also in January 2021, Glass Lewis, a leading proxy voting advisory service, suggested best practices for the use of Rule 10b5-1 trading plans. Recognizing the reality that company insiders routinely have material nonpublic information and the practical need for guardrails to help insiders sell shares, Glass Lewis suggested best practices that companies can follow in order to deter negative investor reactions to insider sales. Starting from the premise that transparency is key, the best practices focus on cooling-off periods; disclosure of the adoption, amendment and/or termination of plans; avoiding the use of multiple, overlapping plans; avoiding short-term plans; and avoiding making changes to existing plans.

— ***Request by Senators for SEC Rulemaking:*** In February 2021, three Democratic US Senators sent a letter to Acting SEC Chair Allison Herren Lee, urging the SEC to reexamine its policies on Rule 10b5-1 trading plans to improve "transparency, enforcement and incentives." Arguing that plan abuses enabling "windfall profits" and lack of transparency damage ordinary investors and undermine public confidence in the markets, the letter suggested possible remedies for "abusive" Rule 10b5-1 trading plan practices, echoing many of the recommendations made in the Stanford study.

MARKET PRACTICES

As part of IPO planning, executives of companies going public sometimes adopt Rule 10b5-1 trading plans before the closing of the IPO. In this circumstance, the adoption of such plans (but not their specific terms) generally should be disclosed in the Form S-1. More commonly, Rule 10b5-1 trading plans are adopted following the IPO. Whether adopted before or after completion of the IPO, the plan terms will need to delay the commencement of sales until the expiration of the IPO lockup period.

The use of Rule 10b5-1 trading plans has grown significantly in recent years among executives of public companies of all sizes and maturities, particularly within larger companies—a majority of S&P 500 companies have executives who utilize Rule 10b5-1 trading plans. The growing prevalence of Rule 10b5-1 trading plans and increased scrutiny of

RECOMMENDATIONS FROM THE STANFORD STUDY

Based on the red flags associated with opportunistic plan selling identified in its research, the Stanford study made the following recommendations for Rule 10b5-1 trading plans:

— *Cooling-off periods:* Require a minimum cooling-off period of 4-6 months,

— *Single-trade plans:* Disallow single-trade plans (plans designed to execute only a single trade).

— *Plans with initial trades prior to earnings announcements:* Remove the affirmative defense of Rule 10b5-1 for plans that are both adopted and start selling shares before the next earnings announcement (noting that a mandatory cooling-off period of 4-6 months would obviate the need for this restriction).

— *Plan disclosures:* Require public disclosure of plans or, at a minimum, public disclosure of the adoption, modification, suspension or termination of a plan and the maximum number of shares scheduled to be sold under the plan; require filers to indicate on Form 4 whether the reported transaction is pursuant to a Rule 10b5-1 trading plan and, if so, the date of plan adoption or modification; and require electronic filing of Form 144 on the SEC's EDGAR system (this would be required by a pending SEC rule proposal).

The study also suggested that companies consider requiring general counsel approval of Rule 10b5-1 trading plans and disallow plan adoption during blackout periods when stock trading by company insiders is prohibited. (Insider trading policies are discussed further on pages 22–23.)

MARKET PRACTICES RELATING TO RULE 10b5-1 TRADING PLANS

PRACTICE	2014 SURVEY	2017 SURVEY	2020 SURVEY
PLAN REVIEW/APPROVAL			
Subject to review and approval by company	79%	77%	80%
Subject to review (but not approval) by company	18%	18%	18%
Not subject to review or approval by company	3%	4%	2%
ELIGIBILITY			
Permitted for all employees	38%	43%	40%
Permitted for insiders only	38%	34%	33%
Required for insiders	8%	7%	10%
Not permitted	16%	16%	17%
WAITING PERIOD			
Require waiting period between plan adoption and commencement of trades	70%	73%	79%
Duration of waiting period, if required:			
1–2 weeks	4%	4%	5%
2 weeks to 1 month	14%	12%	15%
1–3 months	50%	58%	45%
next open window period/fiscal quarter	27%	24%	32%
other	5%	3%	4%
PLAN TERM			
Require minimum term	*	31%	33%
Length of minimum term, if required	*	6 months: 35% 12 months: 61% other: 4%	6 months: 39% 12 months: 60% other: 1%
Require maximum term	*	44%	44%
Length of maximum term, if required	*	12 months: 60% 18 months: 4% 24 months: 33% other: 3%	12 months: 56% 18 months: 7% 24 months: 28% other: 8%
SCOPE OF PLAN			
Permit multiple, overlapping plans	*	35%	33%
Permit trades outside plan	*	51%	51%
PLAN MODIFICATION AND TERMINATION			
Permit plan modification	*	57%	54%
Permit termination prior to plan expiration	*	65%	70%

* Not reported

Source: Domestic Stock Plan Administration Surveys, 2014, 2017 and 2020

these plans and insider trading generally has placed a premium on proper plan design and increased the need for company oversight of Rule 10b5-1 trading plans.

In addition to ensuring full compliance with Rule 10b5-1's technical requirements, directors and officers entering into plans would be well served to keep their selling formulas simple (in order to reduce the possible need for future clarifications or changes that could constitute amendments). Directors and officers should also consider the investor relations considerations associated with frequent plan sales (each of which triggers a separate Form 4 filing requirement) or from use of a plan structure that is likely to result in a single large sale triggered by the achievement of a company milestone or market volatility unrelated to company news.

Based on the three most recent Domestic Stock Plan Administration Surveys co-sponsored by the National Association of Stock Plan Professionals and Deloitte Consulting LLP, conducted in 2014, 2017 and 2020, the accompanying table sets forth the prevalence of various practices relating to the use of Rule 10b5-1 trading plans among public companies of various sizes and across industry sectors. Among other notable results, the 2020 survey found that among responding companies:

— 98% require plans to be reviewed (or reviewed and approved);

— 83% permit plans to be used and 10% *require* insiders to use plans;

— 79% require a cooling-off period between plan adoption and commencement of trading, with the most common waiting period being 1–3 months (45%), followed by the next open window period/fiscal quarter (32%);

— 33% impose a minimum plan term and 44% impose a maximum plan term;

— 33% permit multiple, overlapping plans and 51% permit trades outside plans; and

— 54% permit plan modification and 70% permit termination prior to plan expiration. ■

Nearly all companies going public adopt a new stock incentive plan and many also adopt an employee stock purchase plan (ESPP). Companies should align the size and other terms of these plans with market practices and investor expectations in order to avoid adversely affecting the marketability of the IPO.

STOCK INCENTIVE PLANS

Pre-IPO companies typically have a stock incentive plan that, for a variety of reasons, is rarely suitable once the company goes public. As part of its IPO preparations, a company going public will generally adopt a new stock incentive plan, which differs in various respects from a private company plan:

— *Types of Awards:* Additional types of equity awards, such as stock appreciation rights (SARs), restricted stock units (RSUs), performance awards and cash awards, are usually allowed.

— *Evergreen Provisions:* An "evergreen" feature provides for automatic annual increases in the number of plan shares (equal to a specified percentage of the shares outstanding at the end of the previous fiscal year) for a stated number of years (typically ten). (Note, though, that evergreen provisions will result in adverse recommendations from proxy advisory services if shareholder approval of any plan amendment is sought following the IPO without removal of the provision.)

— *Repricing Prohibition:* Most public company stock plans prohibit the repricing of options and SARs without stockholder approval.

— *Broker-Assisted Exercises:* In a public company, options are most frequently exercised through a broker-assisted process under which shares subject to the option are sold to cover the exercise price and withholding taxes, rather than through cash payment by the optionholder.

— *Section 16:* Grants to directors and officers are usually structured to qualify for an exemption from the short-swing liability provisions of Section 16 of the Securities Exchange Act of 1934.

— *Outside Director Compensation Limits:* Limits on non-employee director compensation—which generally apply to both cash and equity awards—in public company stock plans have become much more prevalent in light of lawsuits challenging excessive director compensation.

EMPLOYEE STOCK PURCHASE PLANS

An ESPP permits employees of a public company to purchase shares of common stock at a discount from the market price. Through the use of payroll deductions, purchases under an ESPP are convenient and avoid brokers' commissions. With proper structuring, an ESPP can also be used as a means to permit employees to invest at a discount from the IPO price.

If the ESPP complies with Section 423 of the Internal Revenue Code, participants receive favorable tax treatment for the shares purchased under the ESPP, including deferral of any tax on the discount until the shares are sold, and the possibility of long-term capital gains treatment for further appreciation if applicable holding periods are met. In practice, many employees immediately sell the shares received and pocket a quick, risk-free gain that is taxed as compensation income.

While Section 423 permits a discount of up to 15% and a "lookback" feature allowing the discount to be taken from the market price at the beginning of the offering period, accounting rules (ASC Topic 718) require companies to recognize compensation expense over the requisite service period for stock grants made under an ESPP, unless the discount is 5% or less and there is no lookback.

The incidence of ESPPs among IPO companies has grown in recent years, with ESPPs generally including a 15% discount and a lookback feature despite the resultant compensation charges. ■

SELECTED STOCK INCENTIVE PLAN METRICS

Stock incentive plans adopted by US companies completing IPOs between 2016 and 2020 (2018–2020 only, for limits on director compensation) had the following attributes:

— **Plan Size:** The number of shares reserved for issuance represented a median of 16.0% of the company's fully diluted shares outstanding upon completion of the IPO.

— **Evergreen Provisions:** An evergreen provision was present in 68% of all plans (and 93% of plans adopted by venture capital–backed companies), with a median automatic annual increase of 4.0% (typically subject to reduction at the board's discretion).

— **Limits on Director Compensation:** 80% of the plans included limits on non-employee director compensation, with the median annual limit being $750,000, and 57% of such plans included a higher limit for the year in which the non-employee director is first appointed or elected to the board.

PREVALENCE AND TERMS OF ESPPs IN IPOs

YEAR	COMPANIES WITH ESPP	ESPP INCLUDES EVERGREEN PROVISION	ESPP DISCOUNT EQUALS 15%	ESPP INCLUDES LOOKBACK FEATURE	INITIAL ESPP OFFERING PERIOD COMMENCES UPON IPO
2020	70%	94%	99%	99%	9%
2019	68%	96%	99%	100%	15%
2018	59%	95%	96%	96%	22%
2017	41%	90%	98%	95%	24%
2016	47%	83%	94%	94%	31%
2016–2020	59%	93%	98%	98%	17%

The Road to IPO: Legal and Regulatory Insights into Going Public

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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, except as otherwise indicated. 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 from SEC filings and PitchBook. Private equity–backed IPO data is sourced from SEC filings and Refinitiv.

Want to know more about the venture capital and M&A markets?

Our *2021 Venture Capital Report* offers an in-depth US venture capital market analysis and outlook, including industry and regional breakdowns. We provide insights into the use of management carve-out plans as retention incentives in private company sales, discuss recent SEC rule amendments that are expanding the financing toolkit for pre-IPO companies, and highlight the importance of transfer pricing compliance for early-stage companies. We also offer a roundup of deal term trends in VC-backed company M&A transactions and convertible note, SAFE and venture capital financings.

See our *2021 M&A Report* for a global M&A market review and outlook, plus an update on takeover defenses for public companies. We examine the impact of buy-side representation and warranty insurance on deal terms in private company sales, look at recent SEC amendments providing financial statement disclosure relief for business acquisitions and dispositions, and discuss the steps boards can take to limit the impact of Delaware courts' increasing openness to shareholder books and records demands. We also compare public and private company M&A deal terms, examine the challenges and potential benefits of pre-IPO acquisitions, discuss the special considerations facing parties doing M&A deals in California, and review deal term trends in VC-backed company acquisitions.

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