Initial Public Offerings (IPO's) are on the rise once again. An IPO is when a company goes public directly by filing an S-1 registration statement for the public sale of its stock. That sale of stock can be by the Company with an underwriter which is known as an IPO. Alternatively, many Issuers are choosing to self-underwrite their public offerings, commonly referred to as a Direct Public Offering (DPO). But of course, the process is highly regulated and without experienced advisors can be difficult, expensive and time consuming.

Pursuant to Section 5 of the Securities Act of 1933, as amended ("Securities Act"), it is unlawful to "offer" or "sell" securities without a valid effective registration statement, unless an exemption is available. Companies desiring to offer and sell securities to the public must file with the SEC, and provide prospective investors, all material information concerning the company and the securities offered. The Securities Act sets forth in-depth rules on what constitutes material information, and on what forms and in what format, that material information must be disclosed.

Rule 404(a) of the Securities Act sets forth the basic requirements for a registration statement. Rule 404(a) reads in part:

"A registration statement shall consist of the facing sheet of the applicable form; a prospectus containing the information called for by Part 1 of such form; the information, list of exhibits, undertakings and signatures required to be set forth in Part II of such form; financial statements and schedules; exhibits; any other information or documents filed as part of the registration statement; and all documents or information incorporated by reference in the foregoing."

Over the years the SEC has created and eliminated various registration forms. Currently all domestic issuers must use either form S-1 or S-3. Form S-3 is limited to larger filers with a minimum of $75 million in annual revenues, among other requirements. All other Issuers must use form S-1.

There are four primary regulations governing the preparation and filing of Form S-1:

(i) Regulation C – contains the general requirements for preparing and filing the Form S-1. Included within Regulation C are regulations and procedures related to (a) the treatment of confidential information; (b) amending a registration statement prior to effectiveness; (c) procedures to file a post-effective amendment; and (d) the "Plain English" rule.

(ii) Regulation S-T – requires that all registration statements, exhibits and documents be electronically filed through the SEC's EDGAR system and must include interactive data using the XBRL process

(iv) Regulation S-K – sets forth, in detail, all the disclosure requirements for all the sections of the S-1. Regulation S-K is the who, what, where, when and how requirements to complete the S-1.

(v) Regulation S-X – sets forth the requirements with respect to the form and content of financial statements to be filed with the SEC. Regulation S-X includes general rules applicable to the preparation of all financial statements and specific rules pertaining to particular industries and types of businesses.

Both the Securities Act of 1933, as amended ("Securities Act") and the Securities Exchange Act of 1934, as amended ("Exchange Act") provide remedies to investors in the IPO and DPO process. The basic premise of such liability is that either an investor was not given an opportunity to review investment disclosure documents prior to making the investment, or such disclosure documents contained inaccurate information or failed to contain material information. The bottom line is that if an officer or director signs a registration statement which is filed with the SEC and which contains misstatements or fails to contain material information, they may be subject to liability on two fronts – from the SEC in an enforcement proceeding, and from individuals and entities in a private civil claim.

Private Placement Followed By Registration

A public company, by definition has public shareholders. Reverse mergers, IPO's and DPO's all result in a public shareholder base. Another option for a Company going public directly is to complete a private placement selling shares to unaffiliated third parties and then to file an S-1 resale registration statement as to those shares. Each of these options results in an unaffiliated public shareholder base. That is, all of these options result in a Company, going public.

The S-1 resale registration statement filed on behalf of selling shareholders is the same, and contains the same required information, as an S-1 registration statement filed on behalf of the Company itself.

The main benefit to a private company going public through the filing of an S-1 Registration Statement as opposed to a reverse merger is that the Company does not have to be concerned about undisclosed, potential or contingent liabilities. Moreover, the SEC rules relating to shell companies (such as Rule 144 and Rule 145) prevent the operating company's shareholders from selling stock using the Rule 144 exemption for twelve months following the completion of the merger. Finally, if not completed correctly the newly merged entity may face trading difficulties with either or both FINRA and DTC.

FINRA and DTC

Following the effectiveness of the S-1 registration statement, the Company will need to engage the services of a market maker to file a 15c2-11 application with FINRA to obtain permission to quote and trade the stock and to receive a trading symbol. FINRA is the self regulatory body which overseas trading on the over the counter market. On the most basic level, FINRA issues trading symbols to company's trading on the over the counter market (including the pink sheets, OTCQB and OTCQX and OTCBB).

The Depository Trust Company (DTC) provides the clearing and settlement services for all the electronic trading of securities in the United States. Over the past year, DTC eligibility has become a concern for many OTC Issuers. DTC has become active in reviewing the securities of issuers and requiring that an Issuer be able to prove, to DTC's satisfaction, that all shares trading electronically are indeed legally entitled to do so. This includes shares that may have been issued in a predecessor company many years before and for which records are not available.

Obtaining and maintaining eligibility is of utmost importance for the smooth trading of an Issuer's float in the secondary market. Moreover, DTC eligibility is a prerequisite for OTC Issuers' shareholders to deposit securities with their brokers and have such securities be placed in street name. Legal & Compliance keeps abreast of DTC requirements to assist clients in avoiding disruptions to their stocks trading activity.

Public Company Compliance

Please see our page entitled Over the Counter Market Compliance for information on how Legal & Compliance can meet all needs as a new public company.

Going Public via Reverse Merger

A reverse merger transaction is one where a private operating entity merges with a public shell company resulting in the private operating company becoming public. Generally the shareholders of the private operating company will exchange their ownership in the private company for a majority stake in the public shell company. A "shell company" is an entity that has no or nominal operations and no assets or assets consisting solely of cash and cash equivalents. A reverse merger is an alternative method of going public (as opposed to an IPO, DPO or private placement followed by registration process).

A reverse merger is often structured as a reverse triangular merger. In that case, the public shell forms a new subsidiary which new subsidiary merges with the private operating business. At the closing the private company shareholders still exchange their ownership for shares in the public company, and the private operating business becomes a wholly owned subsidiary of the public company. The primary benefit of the reverse triangular merger is the ease of shareholder consents. That is because the sole shareholder of the acquiring entity is the public company, the directors of the public company can approve the transaction on behalf of the acquiring subsidiary, avoiding the necessity of meeting the proxy requirements of the Securities Exchange Act of 1934.

The advantages of a reverse merger revolve around time. A reverse merger transaction can be completed very quickly and efficiently. The disadvantages of a reverse merger generally revolve around undisclosed prior issues or liabilities with the public shell, include issues that could affect DTC eligibility going forward. This primary disadvantage can be addressed by hiring competent securities counsel to assist with the due diligence process. Another disadvantage involves costs, a reverse merger transaction, although substantially quicker than an IPO, can cost substantially more. In addition to legal and accounting fees, a private entity must purchase the public shell itself.

Like any transaction involving the sale of securities, the issuance of securities to the private company shareholders, must either be registered under Section 5 of the Securities Act or by subject to an available exemption from registration. Generally, shell companies rely on Section 4(2) or Rule 506 of Regulation D under the Securities Act for such exemption.

SEC Reporting Requirements

Within four days of the private Company going public an 8-K containing all the same information on the private operating business that could be found in a Form 10 registration statement including audited financial statements, must be filed with the Securities and Exchange Commission (SEC). This 8-K is commonly referred to as a "Super 8-K". Since the document is extensive it should be drafted by securities counsel prior to the closing of the reverse merger.