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The DPO Process Including Form S-1 Registration Statement Requirements

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The DPO Process Including Form S-1 Registration Statement Requirements

One of the methods of going public is directly through a public offering. In today's financial environment, many Issuers are choosing to self-underwrite their public offerings, commonly referred to as a Direct Public Offering (DPO). Management of companies considering a going public transaction have a desire to understand the required disclosures and content of a registration statement. This blog provides that information.

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 with the intention of creating a public market or going public must file with the SEC and provide prospective investors with a registration statement containing all material information concerning the company and the securities offered. 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.

The DPO Regulated Time Periods

There are generally three regulated time periods in a DPO:

(i) the pre-filing period, which begins when the Issuer decides to proceed with an offering. During this period, counsel prepares the registration statement and prospectus.

(ii) the waiting or "quiet period," which is the time from the filing of the registration statement until it is declared effective. During this time the Issuer can engage in limited marketing (offers only) of the offering through the use of the filed registration statement, which must clearly indicate that it is not the final document (often referred to as a "red herring").

(iii) the post-effective period, in which the registration statement is effective and the Issuer can proceed with sales of the securities registered.

In addition to disclosure and regulations related to the offering during all three periods, marketing and public communications of the Issuer are restricted. See the section "Restrictions on Communications Related to DPO's" below.

The S-1 In General

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, including within Regulation Care 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.

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(ii) Regulation S-T – requires that all registration statements, exhibits and documents be electronically filed through the SEC's EDGAR system.

(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.

The S-1 In particular

The format of the S-1 is as follows: (i) cover page; (ii) Part I (the prospectus); (iii) Part II (supplemental disclosure); (iv) undertakings; (v) signatures and powers of attorney; (vi) consents; and (vii) exhibits.

Cover Page

The cover page of a Form S-1 is required to set out the following basic information about the Issuer and the offering: (i) the Issuer's exact legal name; (ii) the Issuer's state of incorporation; (iii) the Issuer's SIC code; (iv) the Issuer's tax ID number; (v) the address and telephone number of the Issuer's principal executive offices and of its agent for service of process; (vi) the maximum amount of securities proposed to be offered and amount of registration fee; (vii) the approximate date of commencement of the offering; and (viii) whether any of the securities are being registered "on the shelf" pursuant to Rule 415.

The Prospectus – Part I of the Form S-1

Part I of the Form S-1 contains line items specifying required information by referencing the appropriate sections of Regulations S-K and S-X. The following is a brief description of each of the items required in Part 1 of Form S-1.

Description of Business, Properties and Legal Proceedings (Items 101–103 of Reg. S-K)

Item 101 of Regulation S-K requires a description of the business over the prior 5 years (or 3 years for small public companies) or from inception as appropriate. Item 101 sets forth a list of required information (including, for example, year and state of incorporation; products and services; sources of raw materials; environmental issues; government regulations, research and development and number of employees). In addition, parts of Item 101 require discussion of future plans—for example, plans for expansion or increase in employees. Item 101 also requires a description of the Issuer's competitors specifically and in the industry in general. This paragraph is a brief summary and examples of only a few of the numerous items that must be specifically disclosed and discussed in accordance with Item 101.

Item 102 of Regulation S-K requires that the Issuer set forth the location and general character of the physical properties of the Issuer, including how titled and a description of any liens, mortgages or encumbrances.

Item 103 of Regulation S-K requires that the Issuer disclose any pending or contemplated legal proceedings, including specifically required information about these proceedings. An Issuer need not disclose legal proceedings in the ordinary course of its business.

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Securities (Items 201 and 202 of Regulation S-K)

Items 201 and 202 require a description of the securities being offered as well as past and future information regarding these securities and all of the Issuer's outstanding securities, including, for example, prior market and pricing activity, rights and preferences, outstanding warrants, and dividends.

Financial Information (Items 301-305 of Regulation S-K)

Small Issuers are not required to make disclosure under Items 301 and 302, which require that the Issuer provide a summary of financial data that is contained in the financial statements. All Issuers are required to provide disclosure under Item 303: Management Discussion and Analysis of Financial Condition and Results of Operation (MD&A). MD&A often makes up the bulk of narrative discussion in a registration statement and is arguably the most important portion of the registration statement for investors to understand the Issuer and its management plans. A detailed discussion of the requirements of this section could fill up multiple blogs on this topic alone. However, very briefly, MD&A requires discussion of key financial elements and changes in those items over the prior 12 months. For example, MD&A would disclose revenues for the current term and prior year and explain why that number increased or decreased (i.e., the company may have expanded or cut back on its sales force). In addition, MD&A requires a detailed discussion of the Issuer's future plans and the costs and intended source of financing for those plans. An Issuer cannot simply state that it plans to open 10 new locations, but instead would be required to provide details as to where those locations were, what progress (if any) had been made towards the plan, the costs of the plan and where the money is going to come from.

MD&A requires discussion regarding liquidity and capital resources. This would include breaking out balances owed or owing on various obligations and sources and uses of funds for 12-, 24- and 36-month periods. MD&A requires a discussion of the industry and competition, both generally and as may specifically affect the Issuer. Again, this is a very brief outline of MD&A.

Management and Certain Security Holders (Items 401-404 of Regulation S-K)

Items 401 through 404 of Regulation S-K require disclosure of certain information regarding directors, executive officers, key employees and those that own 5% or more of the outstanding securities of the Issuer. Item 401 requires the Issuer to disclose certain biographical information about officers, directors and key employees. This information includes 5 years of business background, name, age, familial relationships among other disclosed individuals, related party transactions, and involvement in certain legal proceeding over the prior 10 years (such as convictions of crimes, governmental enforcement actions, and involvement in bankruptcies). Item 402 requires disclosure of executive compensation, including that which is past, current and obligated in the future. Item 403 requires disclosure of the legal and beneficial ownership of executive officers, directors and 5%-or-more shareholders. Item 404 requires disclosure of financial related party transactions.

Registration Statement and Prospectus Provisions (Item 501-512 of Regulation S-K)

Items 501-512 (often referred to as standardized items) require different disclosures and information throughout the Form S-1, including specific information on the front and back covers and throughout the Form S-1. Examples include how the offering price was determined (Item 505), risk factors (Item 503), use of proceeds (Item 504), dilution (Item 506), disclosure of selling security holders if a secondary offering (Item 507), plan of distribution (Item 508), experts (Item 509), offering expenses (Item 511), and undertakings (Item 512).

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Part II of the Form S-1

Part II of the Form S-1 registration statement contains supplemental information and formal legal requirements. Part II contains the financial information, sales and issuances of unregistered securities and legal information regarding the exemptions relied upon in making such sales and issuances and information regarding the exhibits attached to the S-1. In addition, a list of exhibits is included in Part II.

Regulation S-X sets forth the form, content and requirements as to the financial statements that must be reviewed and audited by a PCAOB-licensed accounting firm.

Item 601 of Regulation S-K lists required exhibits that must be filed with a Form S-1 (for example, original articles of incorporation and all amendments thereto, material contracts, auditor consent letter, legal opinion, etc.). These exhibits must be filed with the S-1 and become available for public review.

All registration statements must be written in "plain English" as opposed to legalese or industry terminology. The plain English rule requires that the registration statement be written using the following English grammatical principles: active voice; short sentences; definite, concrete, everyday words; tabular presentations of financial information and other applicable data; bullet lists for complex and material data, whenever possible; avoidance of legal jargon; avoidance of highly technical business terms; and no multiple negatives. The SEC enforces the plain English rule and will not hesitate to ask that paragraphs or sections be rewritten.

The Filing and Comment Process

Once the Form S-1 is filed with the SEC, using the EDGAR and XBRL requirements, the SEC will let the Issuer know if the S-1 will be reviewed (they usually are). The SEC assigns a team, including both a legal and an accounting expert, to review the document and provide comments to the Issuer. The Issuer then prepares and files an amendment to the S-1 making the changes and addressing the comments requested by the SEC, and prepares and files a responsive letter which sets forth written direct answers to each of the comments. The comment process can, at times, be arduous and repetitive; however, the Issuer should realize that it is all just part of the process. When the comments are addressed to the satisfaction of the SEC, the Issuer can request and the SEC will issue an order allowing the registration statement to go effective.

The Sale Process

Once the S-1 goes effective, the issuing company can proceed with the sale process. A sale is completed much the same way as in a private offering. That is, an investor executes a subscription agreement and pays for the securities, which are then issued to the investor by the transfer agent.

Restrictions on Communications Related to DPO's

The Pre-Filing Period

"Gun jumping" is the dissemination of information regarding the Issuer before a complete prospectus has been filed with the SEC. Communications prior, during and immediately following the filing of a registration statement are strictly regulated to prevent an Issuer from hyping the market in association with an offering. In addition, the SEC wants to ensure that investors' decisions to participate in an offering are based on information that has been reviewed by the SEC and meet the disclosure standards set forth in the securities laws.

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During the pre-filing period, Section 5(c) of the Securities Act of 1933, as amended (the "Securities Act") makes it "unlawful for any person, directly or indirectly, to… offer to sell or offer to buy… any security, unless a registration statement has been filed as to such security." An offer to sell or offer to buy are broadly defined to include every attempt or offer to dispose of a security for value, including any effort to simulate investor interest in such security.

Moreover, the SEC considers all communications with the public as potential gunjumping violations. A famous example is associated with the IPO of Google, Inc. In a pre-IPO interview with founders Sergey Brin and Larry Page, published in *Playboy* magazine, Brin and Page made favorable comments about Google – of course. The interview did not include any mention of the offering or the securities of the company. Moreover, the statements appeared innocuous, including such generalities as "people use Google because they trust us."

The SEC determined that the interview resulted in gunjumping and required Google to: (1) revise its prospectus to include a risk factor warning that the *Playboy* interview may have violated Section 5; (2) include the full text of the *Playboy* article in the prospectus (thus subjecting its contents to the strict liability standards for the truth and accuracy of information filed with the SEC); and (3) address certain discrepancies between statistics in the article and in the prospectus.

In Google and several other cases, the SEC has found that gunjumping is any information that is not contained in the prospectus and that could stimulate investors' interest. In addition to requiring revisions to a prospectus, as a result of gunjumping, the SEC can require an Issuer to offer to buy back its already issued stock or to delay an offering to allow a cooling-off period, or can initiate enforcement proceedings seeking both injunctive and monetary penalties.

There are exceptions and safe harbors to the gunjumping prohibition. Rule 135 of the Securities Act allows for limited notices of proposed offerings. The notice must clearly indicate that it is not an offer to buy or sell securities. The content of the notice is limited to: (i) the name of the Issuer; (ii) intention to make a public offering; (iii) amount and type of security and basic terms of the offering; (iv) anticipated timing of the offering; (v) whether the offering is limited to a certain class of investors (such as only accredited or only existing security holders); and (vi) any other required statement required by a certain state or foreign governmental body.

Rule 163A of the Securities Act provides a thirty (30)-day safe harbor for communications made at least 30 days prior to the filing of a registration statement and in which communications do not mention or refer to the proposed offering.

Rule 169 allows an Issuer to continue with the release of regular factual information in the ordinary course of business related to the goods and services of the company. The communications cannot mention the offering or securities of the company and cannot contain forward looking statements regarding the company.

Rules 137, 138 and 139 address communications by or to broker-dealers. Basically, communications and negotiations between a potential underwriter or participating broker-dealer and an Issuer, as long as they are confidential, will not be deemed gunjumping.

The Waiting or Quiet Period

The waiting period of an offering is the time following the filing of a registration statement with the SEC and its being declared effective. Oral offers to sell and certain limited communications are allowed during this time, though no sales may be consummated until after the prospectus is declared effective. Moreover, no communications may be made that go beyond the contents of the prospectus as set forth above.

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Finally, the quiet period is the time following the effectiveness of a registration statement and is generally considered to be 30 days. As investors may still be buying into an IPO for this period, Company communications are limited to the contents of the prospectus, updates filed with the SEC, and communications regarding products in the ordinary course of business.

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Securities attorney Laura Anthony and her experienced legal team provides ongoing corporate counsel to small and mid-size OTC issuers as well as private companies going public on the over-the-counter market, such as the OTCBB, OTCQB and OTCQX. For nearly two decades Ms. Anthony has structured her securities law practice as the "Big Firm Alternative." Clients receive fast, personalized, cutting-edge legal service without the inherent delays and unnecessary expenses associated with "partner-heavy" securities law firms.

Ms. Anthony's focus includes, but is not limited to, registration statements, including Forms 10, S-1, S-8 and S-4, compliance with the reporting requirements of the Securities Exchange Act of 1934, including Forms 10-Q, 10-K and 8-K, 14C Information Statements and 14A Proxy Statements, going public transactions, mergers and acquisitions including both reverse mergers and forward mergers, private placements, PIPE transactions, Regulation A offerings, and crowdfunding. Moreover, Ms. Anthony represents both target and acquiring companies in reverse mergers and forward mergers, including the preparation of transaction documents such as Merger Agreements, Share Exchange Agreements, Stock Purchase Agreements, Asset Purchase Agreements and Reorganization Agreements. Ms. Anthony prepares the necessary documentation and assists in completing the requirements of federal and state securities laws and SROs such as FINRA and DTC for 15c2-11 applications, corporate name changes, reverse and forward splits and changes of domicile.

Contact Legal & Compliance, LLC; inquiries of a technical nature are always encouraged.

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