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Tips For Upsizing And Downsizing An IPO

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The preliminary prospectus circulated to potential initial public offering investors will show the number of shares expected to be sold and a bona fide estimate of the price range per share, as required by Regulation S-K Item 501(b)(3). The U.S. Securities and Exchange Commission staff generally takes the position that a bona fide price range means a range no larger than $2 (for ranges below $10) or 20 percent of the high end of the range (for maximum prices above $10).


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Until an IPO registration statement has been declared effective by the SEC, it is possible to file a pre-effective amendment with a new price range and/or a new number of shares to be sold. However, using a pre-effective amendment to upsize or downsize a deal after the price range prospectus has been distributed to investors, i.e., during the road show, can have unwelcome timing implications (for example, the need to obtain a new auditor's consent and updated signature pages and clear any comments from the SEC staff on the new disclosure). In addition, the new filing containing the amended price range could send a signal to the market about pricing that may be premature.

A key question, hence, is how far can the deal be upsized or downsized at pricing and after effectiveness without having to go back to the SEC for permission?

PRACTICE POINT: ***Pre-Effective Amendment***

There are situations in which you may conclude that filing a pre-effective amendment is unavoidable. One example would be where you are certain before effectiveness that your deal is going to be dramatically downsized or upsized. Note that Regulation S-K Item 501(b)(3) requires that you include a bona fide estimate of the price range. In the ordinary course, you would seek to go effective at some point prior to the close of the stock market – 2 p.m. EST is often chosen. Because the market has not yet closed, you would typically not be in a position to know with certainty that you will be pricing outside the range set forth in the prospectus at that time, which allows you to avoid changing the range on the cover of the red at the time you refile.

Rule 430A

Securities Act Rule 430A permits a registration statement to be declared effective without containing final pricing information. Instead, it allows you to insert information retroactively into a registration statement and have it be treated as if it were there as of its effective date. Rule 430A provides that pricing-related information (which includes the price per share and the number of shares offered) that is contained in a prospectus filed pursuant to Rule 424(b) after effectiveness of the registration statement will be deemed to have been part of the registration statement as of the effective date.[1]

Here is a summary of how Rule 430A works:

If you are…	Then you should use…	And you can…	But you would need to…
Upsizing your deal	Instruction to Rule 430A(a)	Increase the price per share and/or number of shares, so long as the aggregate size of the revised deal does not exceed 120 percent of the amount shown in the fee table in the registration statement at the time of effectiveness	File an immediately effective registration statement under Rule 462(b) to register any increase in shares or deal size not already provided for; Consider whether additional disclosure about the revised deal (a new use of proceeds, for example) needs to be delivered to purchasers (orally or by means of a free writing prospectus, or FWP) prior to confirmation of sale
Downsizing your deal	SEC Staff Compliance and Disclosure Interpretation (C&DI) 627.01	Decrease the price per share and/or decrease the number of shares sold, so long as the size of the revised deal is not less than the lower end of the deal size reflected in the price range prospectus, minus 20 percent of the maximum deal size reflected in the price range prospectus	Consider whether additional disclosure about the revised deal (liquidity issues, for example) needs to be delivered to purchasers (orally or by means of an FWP) prior to confirmation of sale

Instruction to Rule 430A(a)

Rule 430A's most important contribution to pricing outside the range is found in the instruction to paragraph (a), which provides that, where the 20 percent safe harbor threshold is not exceeded, changes in price and deal size can be poured backwards in time into the registration statement using a Rule 424(b) filing of the final prospectus after the effectiveness of the registration statement, and this pricing information will be deemed to have been part of the registration statement at the time it

became effective. This is a very useful device indeed. It allows you to change the size of your deal by 20 percent in either direction without having to go back to the SEC.

C&DI 227.03

C&DI 227.03 establishes two important points:

- for purposes of Rule 430A, retroactive changes in price and/or deal size within the 20 percent threshold can be made after the fact by way of a Rule 424(b) prospectus, even if the effects of those changes are material; and

- even deal size changes outside the 20 percent threshold can be made using a Rule 424(b) prospectus if the size changes do not materially change the disclosure.

Rule 430A effectively lets you make pricing-related changes to your registration statement without SEC review (i.e., without filing a post-effective amendment), even if those changes are material. This special privilege is limited to pricing information as contemplated by Rule 430A, but it is a very special privilege nevertheless. The second point is equally important — changes in excess of 20 percent may not be material.

PRACTICE POINT: ***When is a Greater Than 20 Percent Change Not Material?***

Consider a $1 billion offering that is half primary and half secondary shares. If the secondary shares are reduced to $250 million, but the primary shares stay at $500 million, the offering has been reduced by 25 percent but the reduction may well not be material. There will still be a very substantial public "float" after the offering and the proceeds to the issuer (and hence the use of proceeds); the pro forma number of shares outstanding and the pro forma earnings per share will not change at all. This sort of fact pattern is right in the center of C&DI 227.03's fairway.

C&DI 627.01

What does Rule 430A have to say about the deal size actually reflected in the prospectus circulated to investors, as opposed to the maximum deal size reflected in the fee table on the cover of the registration statement? What if (as is often the case) these two amounts are not aligned?

This is where C&DI 627.01 comes into play. C&DI 627.01 permits you to calculate the 20 percent amount for purposes of downsizing your deal in a very favorable way. As an alternative to the 20 percent-of-the-amount-in-the-fee-table approach contemplated by the instruction to paragraph (a) of Rule 430A, C&DI 627.01 allows you to derive your 20 percent amount by multiplying the upper end of the range in the price range prospectus by 20 percent.[2]

You can then add that amount to the upper end of the range in the price range prospectus if you are upsizing, or subtract that amount from the bottom of the range if you are downsizing, to figure out what share count and price per share will be within the safe harbor. Since 20 percent of the upper end of the price range is by definition greater than 20 percent of the lower end of the price range, C&DI 627.01 effectively broadens the scope of the Rule 430A safe harbor for troubled deals.

The approach in C&DI 627.01 represents an alternative to the approach in the instruction to paragraph (a) of Rule 430A, and the SEC staff takes the positions that you cannot "mix and match" between the C&DI and the instruction to paragraph (a). As a result, if you are following C&DI 627.01, you may not take 20 percent of the amount reflected in the fee table and subtract that from the lower end of the price range, even though that might yield a lower floor on your transaction than 20 percent of the upper end of the range (since the fee table often registers a larger transaction than the upper end of the range). Either you calculate using the fee table or you calculate using the range in the price range prospectus, but you can't have it both ways. In practice, this means that you will want to use C&DI 627.01 when downsizing and the instruction to paragraph (a) of Rule 430A when upsizing.

Those who qualify for the special treatment offered by Rule 430A and the related rules will find it much more attractive to make the necessary changes to the terms of the deal after effectiveness, in almost all cases. Therefore, the key question for the deal team will be whether the proposed changes to the number of shares to be sold and the price per share qualify for Rule 430A's special magic.

Section 11 and Section 12

Section 11(a) of the Securities Act imposes liability if any part of a registration statement, at the time it became effective, "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." Section 11 liability only covers misstatements or omissions in the registration statement at effectiveness. We think of the registration statement at the magic moment of effectiveness as the "Section 11 file." This is a helpful way to remember that Section 11 is a highly technical provision, in the sense that it looks only at (a) what is or is deemed to be in the registration statement (b) at the time it became effective.[3]

By contrast, Section 12(a)(2) of the Securities Act is not limited to the registration statement and is not linked to the moment of effectiveness. It imposes liability on any person who offers or sells a security in a registered offering by means of a prospectus, or any oral communication, which contains "an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading." Section 12(a)(2) is less technical and more holistic than Section 11. Section 12(a)(2) takes into account all oral statements, FWPs and statements in the price range prospectus rather than focusing exclusively on the registration statement.

Because Rule 430A relates only to the registration statement at the time of effectiveness, it only serves to update disclosure for purposes of Section 11 of the Securities Act. Section 12, on the other hand, looks to the sum of what investors have been told at or before the time the underwriters confirm orders. Section 12's focus, therefore, is the price range prospectus sent to investors and any additional information that may have been conveyed to investors (orally or in writing) on or before the time of pricing. We think of this collection of information as the "Section 12 file."

In order to deal with all of the issues that arise in the context of changing the size and price of an IPO after the registration statement has been declared effective, you will need to keep in mind both your "Section 11 file" and your "Section 12 file."

The Section 12 File

Securities Act Rule 159, FWPs, Exchange Act Rule 15c2-8(b)

Rule 159 makes clear that, for purposes of Section 12, information conveyed to a securities purchaser after the time of sale does not count for purposes of determining whether the Section 12 file was complete at the moment that liability attaches. In other words, Section 12 liability is a function of what you actually gave or told the purchaser prior to confirming the order — anything delivered after the Rule 159 "moment of truth" does not count.

This means that those material pricing changes that can be retroactively poured into the Section 11 file after the fact under Rule 430A must actually be conveyed to purchasers in real time prior to confirming orders in order for the Section 12 file to be up to snuff. There are a number of ways to transmit the required information — the rules are agnostic as to the actual method of conveyance — but the key point is that the conveyance must be made, and it must be made prior to confirming orders.

Market practice is that simple information that can be effectively reduced to sound bites is conveyed orally. It is customary in deals pricing within the range, for example, to convey the final pricing information orally.

Oral conveyance is also used in many upsizing and downsizing scenarios. The easiest example of this would be a 20 percent decrease in deal size in an all-secondary offering by a selling stockholder. All the investor needs to know in that case is how many shares are being sold and at what price — there are no collateral disclosure implications to the change in deal size in that example.[4] The disclosure in the price range prospectus will not otherwise change at all.

More complicated deal changes may require that an FWP summarizing the changes be circulated to accounts in writing as permitted by Rule 433. The decision whether to convey the new information orally or in writing will, in part, depend on whether the price range prospectus circulated to investors contained "sensitivity analysis" explaining how the company's plans would change if the actual proceeds turned out to be more or less than the amount assumed in the price range prospectus. The more sensitivity analysis that is included in the price range prospectus, the more likely it will be possible to convey the missing information orally at the time of pricing. This is a key point to keep in mind in the early drafting sessions.

PRACTICE POINT: ***Sensitivity Analysis***

There is no hard-and-fast rule about how much sensitivity analysis will suffice and what topics need to be covered. The only certainty is that more is better when you are trying to make significant deal changes at the end of the road show. Here are some of the places where we have found sensitivity disclosure to be particularly useful:

- use of proceeds, particularly where stated uses would need to be changed or new uses added. It's always best to disclose multiple uses of proceeds in the order of their priority so that it's clear which uses will be skipped or skinnied if the deal is downsized;
- pro forma earnings per share, balance sheet and capitalization;
- the size of the "float" after the offering;
- the company's liquidity position (or burn rate) after the offering;
- the level of beneficial ownership by members of senior management or other significant stockholders; and
- dilution.

The goal is to have disclosure that allows investors to see how changes in share price or deal size ripple through critical elements of the disclosure. Ideally, the price range prospectus will present all deal-size related disclosures in an "if/then" format ("We will apply the net proceeds from this offering first to repay all borrowings under our credit facility and then, to the extent of any proceeds remaining, to general corporate purposes," for example).

Finally, where the changes are so fundamental that the original price range prospectus must be completely rewritten, it may be necessary to recirculate a completely new price range prospectus in order to satisfy Exchange Act Rule 15c2-8(b). Rule 15c2-8(b) requires that brokers and dealers participating in an IPO "deliver a copy of the preliminary prospectus to any person who is expected to receive a confirmation of sale at least 48 hours prior to the sending of such confirmation."

The line between a complete recirculation and a supplemental circulation of changed pages is a blurry one. The FWP concept introduced by Rule 433 in the 2005 securities offering reforms was intended, we believe, to obviate the need for a full recirculation of a completely new price range prospectus in all but the most extreme cases. However, when changed pages become so pervasive that the original price range prospectus can no longer be said to be "the preliminary prospectus" within the meaning of Rule 15c2-8(b), then a full recirculation may be required. If the changes are less than pervasive, an FWP summarizing the changes should suffice.

The key import of this distinction between a full recirculation of a new price range prospectus and a supplemental circulation of an FWP summarizing the changes relates to timing. If you have tripped the Rule 15c2-8(b) wire, you need to give investors 48 hours (generally thought to mean two full business days)[5] to consider the revised disclosure. If you are in FWP land, however, you may conclude that investors only need a few hours (or even minutes) to digest the new disclosure. The SEC staff has, to date, refrained from offering any guidance on the question "How long is long enough?" as it relates to delivery of new information for purposes of Rule 159 and Section 12. We believe most information can be digested upon receipt, and only very complicated changes need a full business day to be absorbed. Somewhat complicated changes may need more than a few minutes to be digested but less than a full business day.

PRACTICE POINT: ***FWP Versus Recirculation***

We believe that the FWP concept introduced by Rule 433 in 2005 obviates a full recirculation of a revised price range prospectus in all but the most extreme cases. An FWP that summarizes the disclosure changes and attaches the key changed pages is almost always sufficient.

Filing Fee Issues — Securities Act Rules 457 and 462(b)

Rule 457

Although Rule 457 deals with the seemingly mundane issue of the calculation of the registration fee, the choice you make under Rule 457 will have a significant impact on your options if your deal is upsized or downsized at the end of the road show after you have gone effective under Rule 430A.

Remember that you initially filed your registration statement with a fee table, calculated either:

- under Rule 457(o) on the basis of the amount of proceeds the issuer wanted to raise; or
- under Rule 457(a) on the basis of the number of shares to be sold and a bona fide estimate of the sale price per share.

Chances are, you opted to calculate the registration fee for purposes of the fee table under Rule 457(o). You could have used Rule 457(a) instead, but since doing so would let the market know the likely per share price (i.e., maximum deal size divided by the number of shares registered) most deal teams opt to use Rule 457(o) for the initial filing.[6]

When the time comes to file your price range prospectus, however, you have a choice: either keep using Rule 457(o), or refile your fee table under Rule 457(a).

If you choose to refile under Rule 457(a), you will not have to pay more filing fees if your offering price per share later increases — that's baked right into the text of the rule. You will, however, be required to pay additional filing fees if you later increase the number of shares to be offered, even if the total offering size (number of shares sold times sale price) does not go above the original estimate used to calculate the original filing fee. The added shares will need to be registered on an immediately effective registration statement under Rule 462(b) — we discuss below how that is done.

If you stick with Rule 457(o), you will not have to file a new registration statement and pay additional filing fees if your per share price goes down and you increase the number of shares offered so as to maintain the original aggregate offering price.[7] You will, however, be required to pay additional filing fees if you keep the same number of shares and increase the per share price (thereby increasing the aggregate deal size).

PRACTICE POINT: ***Rule 457(a) Versus Rule 457(o)***

Which route is preferable? Refiling under Rule 457(a) allows you to increase the price per share (but not the number of shares) without filing an additional registration statement. By contrast, staying with Rule 457(o) allows you to increase the number of shares and decrease the price per share so as to maintain overall deal size without filing an additional registration statement. So it all boils down to whether you think you will be upsizing price only (and leaving the number of shares unchanged) or will be playing with both price and number of shares in order to keep the same total aggregate deal size. Many deal teams elect to switch to Rule 457(a) at the time of printing the price range prospectus because increasing the price per share at pricing is a more likely outcome than increasing the number of shares and decreasing the price.

Rule 462(b)

How do you go about adding additional shares (if you are using Rule 457(a)) or increasing the deal size (if you are using Rule 457(o))? Before effectiveness, you can refile with a new fee table on the cover. After effectiveness, you need to file an immediately effective registration statement under Rule 462(b).[8]

Rule 462(b) is available if:

- you file the new registration statement prior to the time confirmations are sent; and
- the increase in price and share count together represent an increase of no more than 20 percent of the previous maximum aggregate offering price, as set forth in the fee table (not the cover of the price range prospectus) at effectiveness.

There is a curious wrinkle to how the 20 percent amount is calculated for purposes of Rule 462(b), again depending on whether you refiled your fee table under Rule 457(a) or stayed with Rule 457(o). If you are using Rule 457(a), you multiply the number of additional shares by the new offering price and then look to see whether the increase in deal size associated with the added shares is more or less than 20 percent of the deal size in the fee table at effectiveness, even though that fee table was calculated at the old price per share.[9] To take an example, imagine that your fee table at effectiveness reflected 11.5 million shares and a price range of $8 to $10 per share, for a maximum aggregate deal size of $115 million. At pricing, the number of shares is increased by 1.5 million and the price is increased to $12 per share. The number of additional shares times the price equals $18 million. Since this is less than 20 percent of $115 million (i.e., less than $23 million), you can use Rule 462(b) to register the new shares. The fact that the entire deal is actually being upsized by more than 20 percent (since $115 million plus 20 percent equals $138 million, and 13 million shares times $12 per share equals $156 million) is disregarded if you are using Rule 457(a).

The calculation is done differently if you stayed with Rule 457(o). In that case, you multiply all of the shares being offered (including the additional shares) by the new price per share and then look to see if you have increased total deal size by more than 20 percent.[10] This makes sense, since Rule 457(o) looks to total deal size. To use our example above, 20 percent of the original maximum deal size equals $23 million. Because 13 million shares are being offered at a new price per share of $12, total deal size would be $156 million, which is more than the original deal size plus 20 percent ($115 million plus $23 million equals $138 million). As a result, you could not use Rule 462(b) to register the full amount of the additional deal size.

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[1] Rule 430A defines pricing information as: "information with respect to the public offering price, underwriting syndicate (including any material relationships between the registrant and underwriters not named therein), underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices and other items dependent upon the offering price, delivery dates, and terms of the securities dependent upon the offering date."

[2] We're assuming that the prospectus at effectiveness is the same price range prospectus circulated to investors — in other words, that you have not refiled with a different range.

[3] The time of "effectiveness" is a key moment in the IPO. Among other things, securities cannot be sold until the registration statement is declared effective. Rule 430A allows an IPO to price as many as 15 business days after effectiveness, but it is most common to price on the day of effectiveness (which is also the time the underwriters will begin confirming orders). The actual closing of the transaction happens some number of days later.

[4] Note, however, that one consequence might be a material change to the ownership structure (for example, if the change resulted in a control group's retention (or loss) of control over the company).

[5] In other words, if prospective investors actually have the revised preliminary prospectus in their hands at 9 a.m. on Monday morning, it would be appropriate to price on Tuesday after the market closes.

[6] There is a technical reason why it is generally preferable to choose Rule 457(o) at the outset. The SEC staff informally takes the position that if you raise your price range in a preliminary prospectus contained in a pre-effective amendment from the range used to calculate the filing fee and you originally elected to proceed under Rule 457(a), then the 20 percent safe harbor contemplated by the instruction to paragraph (a) of Rule 430A is calculated on the basis of the original maximum aggregate offering price and not the offering price range contained in the price range prospectus distributed to investors. This qualification can be eliminated if you "voluntarily" pay an additional filing fee when you increase your offering range, but doing so defeats the primary benefit of Rule 457(a) (i.e., you do not need to go back to the SEC if you increase your estimated price per share). This SEC staff position can be a trap for the unwary issuer who elected to use Rule 457(a) originally to calculate the filing fee and later seeks to upsize. There is no such hidden problem for users of Rule 457(o), as they are required to pay additional filing fees at the time they upsize their deal, and they know it.

[7] See C&DI 640.05.

[8] You will also need to remember to include a new Exhibit 5.1 opinion on the legality of the additional securities being registered. This can be done by means of an immediately effective post-effective amendment under Rule 462(d). Note, by the way, that Rule 462(b) works for an increase in transaction size in a Rule 457(o) deal, even though the text of Rule 462(b) speaks only of "registering additional securities." See C&DI 640.04.

[9] See C&DI 640.03.

[10] See C&DI 640.04.