THE PROGRAM IN THE LAW AND ECONOMICS OF CAPITAL MARKETS

COLUMBIA LAW SCHOOL

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"Going Public in the 2020s" Conference

March 3, 2023

As part of the New Special Study of the Securities Markets, the Columbia Law School/Business School Program in the Law and Economics of Capital Markets is holding a conference at Columbia Law School on March 3, 2023 concerning recent developments in the ways by which a previously privately-held firm can create a liquid secondary trading market for its stock. The focus will be on what we can learn from these developments and their implications for the traditional IPO "going public" process. These developments include the 2020-2021 boom in SPACs and in traditional IPOs, followed in each case by a 2022 collapse; the NYSE and Nasdaq rules permitting direct listings; and the new ways that a firm, without Securities Act of 1933 ("Securities Act") or Securities Exchange Act of 1934 ("Exchange Act") registration, can potentially create a relatively liquid secondary market, ways that arise out of the amendments to these Acts contained in the JOBS Act and the FAST Act.

The Traditional Story

A security that trades in a liquid secondary market is generally more valuable than one with an identical future expected cash flow that does not. For this reason, firms at a certain point in their development often seek to have their shares trade in such a market. There is social value in their being able to do so, at least under the right circumstances.

In the United States, the traditional route to having a liquid secondary trading market is through an initial public offering ("IPO") registered under the Securities Act. The IPO process has perennially been subject to some well-known concerns, at least in the eyes of many commentators. One concern is IPO underpricing, as measured by the average first-day jump in trading price. A second is the level of underwriting fees that an issuer must pay. A third is the cost of mandated disclosures, both under the Securities Act at the time of the offering and periodically thereafter under the Exchange Act, and the threat of heightened liability for disclosure errors at the time of the offering. Various critics, pointing to one or more of these concerns, have said that they have unnecessarily dampened the number of firms that make such offerings relative to what would be socially desirable. The level of IPOs occurring in the first two decades of this century has been cited as evidence that these critics were correct. Other commentators view these concerns more benignly as the inevitable consequences of a process that has substantial adverse selection aspects.

New Developments

The story has become more complicated in recent years due to a number of developments.

1. Going public privately. A series of reforms to the Securities Act and Exchange Act under the JOBS Act (2012) and the FAST Act (2015) laid the groundwork for what we might refer to as the "going public privately" option. These reforms make it easier to raise money broadly

without Securities Act registration, and to have a relatively liquid market for the stock sold this way without a listing on a national securities exchange or Exchange Act registration. One such private market reform is the JOBS Act mandate resulting in the SEC's Rule 506(c), which allows public solicitation for offerings without mandated disclosure or heightened liability. The actual purchasers, however, are restricted to being accredited investors and the securities must be held for a certain time before they are freely tradeable, unlike shares purchased in a public offering. Another one of these "going public privately" reforms is the JOBS Act Regulation A+. This allows public solicitations for offerings up to $75 million without restriction as to the type of investor, and utilizes a disclosure and liability regime considerably less burdensome than with a Securities Act registration. Yet another such reform is the JOBS Act amendment to the Exchange Act Section 12(g) raising the trigger from 500 shareholders of record to 2000 before a stock not trading on a registered national securities exchange must be registered under the Exchange Act and are thus required to provide mandated periodic disclosure. And finally there is the FAST Act amendment to the Securities Act adding a Section 4(a)(7), which permits immediate resale of newly offered stock without Securities Act registration as long as the trading is among accredited investors. These various reforms gain potentially increasing importance as non-exchange electronic trading venues take advantage of the rapid advances in information and distributed ledger technology.

2. Direct Listings. The New York Stock Exchange ("NYSE") and Nasdaq have each adopted rules approved by the SEC that have allowed firms meeting certain standards to directly list on their exchanges without a public offering. Like an IPO to be listed on an exchange, both an Exchange Act and Securities Act registration is still necessary, but no underwriter is involved, saving the issuer those expenses and being subject to the scrutiny of underwriter due diligence. Depending on how the Supreme Court rules in *Fiyyaz Pirani v. Slack Technologies*, the issuer may also avoid Section 11 absolute liability for misstatements in the Securities Act registration statement. Each exchange has also adopted a rule approved by the SEC allowing a direct listing that includes capital raising through the issuer directly making offers for its shares on the exchange. The approach still allows the issuer to avoid the expenses an underwriter and it is not clear that the investment bank acting as the advisor will need to do due diligence in order to avoid the risk of Securities Act Section 11 underwriter liability.

3. SPACs. In 2020 and 2021, there was a two-year explosion in SPAC offerings, with the 2020 number rising to 247 from 59 the year before, and the 2021 number rising yet further to 613. This was followed by a collapse back down to 76 for the first three quarters of 2022. SPACs require Securities Act registration, actually twice, initially at the time of the offering of the SPAC's shares, and later, in the "deSPAC" transaction, to register the shares of the private company being merged with the SPAC. The initial transaction involving a public offering of the SPAC's shares involves traditional underwriters, but underwriter due diligence in response to potential Section 11 liability is minimal because there is very little on which to do diligence. As for the second "de-SPAC" transaction, whereby a private company is merged into the SPAC, there is no underwriter purchasing and reselling shares. SPAC adherents maintain that this means that the investment bank acting as the investment advisor in this second transaction has no underwriter liability, which, if correct, means they do not need to do diligence to avoid this liability (a position that will no longer be viable if the rules the SEC has proposed with respect to SPACs are adopted and upheld by the courts). SPAC adherents also maintain that because the merged company resulting from the de-SPAC transaction involves a company that is already public, the S-4 registration statement at the time of the merger is not subject to the traditional IPO exception to the PSLRA's earnings

projection liability safe harbor (though this position is disputed by some commentators and would be definitively rejected if a bill currently pending in Congress is adopted into law).

4. IPOs. Certain reforms made pursuant to the JOBS Act (2012) and the FAST Act (2015) have been designed to make the mandated disclosures and other offering process restrictions imposed by Securities Act registration less burdensome, particularly for firms classified as "emerging growth companies." In 2020 and 2021, there was, contemporaneous with the SPAC boom, a two-year explosion in IPOs, with the 2020 number rising to 480 from 232 the year before, and the 2021 number rising yet further to 1080 in 2021. This too was followed by a collapse back down to 162 for the first three quarters of 2022.[1]

Conference Panels: Lessons to Be Learned

We contemplate that the conference will have four panels, one devoted to what can be learned from each of these developments. The following suggests the kinds of questions that could be addressed by the relevant panel.

1. Going public privately. How much have the "going public privately" reforms been used to accomplish aims similar to those of a company raising capital and acquiring liquidity for its shares through a traditional IPO? Why has this route to accomplishing these aims not been used more? What, if anything, does this tell us about the value of Securities Act and Exchange Act registration, despite the burdens they impose? Would further reforms make this route more viable and would such reforms be socially desirable?

2. Direct listings. How much has the non-capital raising NYSE and Nasdaq direct listing route been used to acquire share liquidity? How much has the capital raising direct listing route been used to both acquire share liquidity and raise capital? What, if anything, does this tell us about the value of the public offering process, whether through a traditional IPO or a SPAC? Said another way, does the record to date of direct listings suggest a growing disintermediation in our capital markets, or does it suggest that, one way or another, there is a continuing important role for investment banks in the process by which companies can generate a liquid market for their stocks?

3. SPACs. What does the explosion of SPACs followed by their decline tell us about the strengths and weaknesses of the traditional IPO process and the way it is regulated? Will SPACs be an ongoing alternative to the traditional IPO in the future, and, if so, what socially useful role do they offer that IPOs do not? Would it be desirable for the investment advisor in the de-SPAC transaction to be considered an underwriter for Section 11 liability purposes and should de-SPAC registration statements be subject to the IPO exception to the PSLRA's forward looking information liability safe harbor?

4. IPOs. What does the explosion of IPOs followed by their decline tell us about the perennial critiques of the process and does this sharp increase followed by decline help us understand the lower level of IPOs in the first two decades of this century? What has been the

[1] A different point of comparison between IPO trends and SPAC trends is the rate of "deSPAC" transactions. A SPAC typically has 24 months to find a merger partner. If it fails, its money is returned to its investors and it represents a failed attempt to create a public market for a previously private company. Thus, the deSPAC rate represents a measure of successful SPAC transactions, but it involves a lag. Comparing the first three quarters of 2021 to the first three quarters of 2022, the number of deSPAC transactions declined from 150 to 74, while the number of IPOs dropped from 773 to 162.

effect of the reforms pursuant to the JOBS Act and FAST Act intended to make the Securities Act registration process less burdensome for IPOs? Would further reforms be desirable, such as allowing companies a broader capacity to test the waters with respect to a proposed offering before they being required to file a registration statement?