

Corporate Finance Alert

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New SEC Staff Position on Price Range in IPO Preliminary Prospectus

In March 2012, the SEC Staff announced a welcome change to its long-standing view regarding the estimated price range that must be included on the cover of an initial public offering (IPO) prospectus used prior to effectiveness of the registration statement.¹

This alert:

- reviews briefly the requirement for an IPO preliminary prospectus to disclose a *bona fide* estimate of the range of the maximum offer price;
- describes the recent change in the Staff's view on the acceptable magnitude of that estimated price range; and
- notes some of the ways in which the Staff's changed position on price range disclosure may afford issuers and underwriters additional flexibility in certain offerings.

Price Range Disclosure Requirement

Section 5(b)(1) of the Securities Act of 1933 (the Securities Act) provides that issuers can distribute or otherwise use a prospectus prior to effectiveness of the related registration statement only if the prospectus meets the requirements of Section 10 of the Securities Act, which governs the information required to be included in a prospectus. To meet the requirements of Section 10, a prospectus used prior to effectiveness of the registration statement, commonly referred to as a "preliminary prospectus" or "red herring prospectus," generally must be substantially complete and, for IPOs, must contain on the cover page a *bona fide* estimate of the range of the maximum offering price.² Use of a non-compliant preliminary prospectus would violate Section 5 of the Securities Act, exposing the issuer to a right of rescission on the part of purchasers of the offered securities under Section 12(a)(1) of the Securities Act.³

Prior Staff View

Before March 2012, the Staff was of the view that, other than during periods of extraordinary market volatility, the size of the price range set forth on the cover of the preliminary prospectus for an IPO conducted as a traditional cash offering (with pricing and allocation determined by the issuer and the underwriters and not through an auction process) generally should be no more than the greater of \$2 or 10 percent of the high end of the price range.⁴

New Staff View

The Staff's new view on the price range estimate required in a preliminary prospectus for an IPO conducted as a traditional cash offering is that the range should be no more than \$2, if the maximum price is \$10 or less, or 20 percent, if the maximum price is greater

Four Times Square
New York, NY 10036
212.735.3000

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than \$10. Relative to the prior Staff position, this new view permits a broader estimated price range for IPOs for which the high end of the estimated range exceeds \$10.

In publicly expressing its new price-range view, the Staff did not address the question of whether the calculation of the size of the range should be based on 20 percent of the high end of the estimated range, 20 percent of the low end of the estimated range or 20 percent of some other point within the estimated range. We have confirmed the Staff's view with respect to this question: In the case of offerings where the maximum price is greater than \$10, the 20 percent range is calculated based on the high end of the price range disclosed on the preliminary prospectus cover.⁵

Impact of New Staff View

The Staff's new policy will facilitate higher-priced offerings in a number of respects. The ability to disclose a wider price range in the preliminary prospectus will, for example, permit issuers and underwriters to establish a price range that better reflects the uncertainties of today's IPO market. Further, in an IPO that experiences weaker than expected demand and prices below the estimated range disclosed in the preliminary prospectus, the new wider price range effectively will make it easier to downsize the offering without triggering the need for a post-effective amendment to the IPO registration statement that would have to be reviewed and declared effective by the Staff before the IPO could be completed.⁶

Comparison Tables

The following tables present comparisons of the generally permissible estimated price ranges disclosed in the preliminary prospectus under the old Staff view and under the new Staff view for a traditional for-cash IPO.

Table 1 shows the comparison for a hypothetical lower-priced IPO (maximum price per share of \$10 or less) in which the high end of the estimated price range is \$8 per share, and Table 2 presents the comparison for a hypothetical higher-priced IPO (maximum price per share in excess of \$10) in which the high end of the estimated price range is \$40 per share.

TABLE 1

Hypothetical IPO Preliminary Prospectus
Price Range Based on \$8 High End

Staff View	Price Range	
	Low End	High End
Old	\$6.00	\$8.00
New	\$6.00	\$8.00

TABLE 2

Hypothetical IPO Preliminary Prospectus
Price Range Based on \$40 High End

Staff View	Price Range	
	Low End	High End
Old	\$36.00	\$40.00
New	\$32.00	\$40.00

END NOTES

- 1 Meredith B. Cross, Director, Division of Corporation Finance, United States Securities and Exchange Commission, Remarks at the ABA Business Law Section 2012 Spring Meeting, Las Vegas, NV. (March 23, 2012).
- 2 Item 501(b)(3) of Regulation S-K requires the inclusion of a *bona fide* price range in a “for cash” IPO preliminary prospectus that is circulated. The Staff will apply this requirement to an IPO even if the offering is not underwritten or is made by selling shareholders.
- 3 New Section 5(d), added to the Securities Act as part of the Jumpstart Our Business Startups Act (JOBS Act) enacted in April 2012, permits emerging growth companies (as defined in Section 2(a) under the Securities Act) pursuing an IPO to engage in oral or written communications with qualified institutional buyers (as defined in Rule 144A under the Securities Act) and institutional accredited investors (as defined in Rule 501 under the Securities Act) in order to gauge their interest in the proposed IPO either prior to or following the initial filing of the IPO registration statement. Omission of an estimated price range from an IPO prospectus circulated as a qualifying communication under this new provision would not result in a violation of Section 5 of the Securities Act. For a discussion of the JOBS Act, click [here](#).
- 4 In the case of IPOs that use a pricing approach similar to a Dutch auction, the Staff has permitted a price range of \$4 or 20 percent, based on the high end of the range included in the preliminary prospectus. Google, Inc., for example, included a price range of \$108 - \$135 in an early [preliminary prospectus](#) for its IPO, which was priced using an auction process (due to market conditions, Google ultimately included a reduced price range in its last pre-effective amendment).
- 5 The preliminary prospectus filed by Facebook, Inc. on May 3, 2012 reflected the greater latitude afforded to issuers under the Staff’s changed view. The May 3, 2012 preliminary prospectus disclosed an estimated price range of \$28 - \$35 per share, such that the \$7 breadth of the range was equal to 20 percent of the \$35 high end of the range. The Staff has confirmed to us that the price range of \$28 - \$35 included in the May 3, 2012 preliminary prospectus complied fully with its new view.
- 6 Rule 430A under the Securities Act and the instructions to that rule permit changes in price and offering size that do not exceed 20 percent of the maximum aggregate offering price set forth in the “Calculation of Registration Fee” table in the effective registration statement for the offering to be reflected in a final prospectus that is filed with the SEC, but does not need to be declared effective by the Staff. The Staff has provided helpful alternative guidance for calculating the 20 percent threshold that an issuer may rely on when the price range disclosed in the preliminary prospectus differs from the estimates embodied in the registration statement’s fee table. [Securities Act Rules Compliance and Disclosure Interpretation 627.01](#) states that “[t]he 20 percent threshold may be calculated using the high end of the range in the prospectus at the time of effectiveness and may be measured from either the high end (in the case of an increase in the offering price) or low end (in the case of a decrease in the offering price) of that range.” For a discussion of the issues arising from changing the number of shares to be sold or establishing an offering price above or below the price range that was previously disclosed in the preliminary prospectus, click [here](#).

Attorney Contacts

New York Office

Richard B. Aftanas

212.735.4112

richard.aftanas@skadden.com

Gregory A. Fernicola

212.735.2918

gregory.fernicola@skadden.com

David J. Goldschmidt

212.735.3574

david.goldschmidt@skadden.com

Stacy J. Kanter

212.735.3497

stacy.kanter@skadden.com

Phyllis G. Korff

212.735.2694

phyllis.korff@skadden.com

Andrea L. Nicolas

212.735.3416

andrea.nicolas@skadden.com

Dwight S. Yoo

212.735.2573

dwight.yoo@skadden.com

Michael J. Zeidel

212.735.3259

michael.zeidel@skadden.com

Washington, D.C.

Brian V. Breheny

202.371.7180

brian.breheny@skadden.com

Los Angeles Office

Jonathan B. Ko

213.687.5527

jonathan.ko@skadden.com

Gregg A. Noel

213.687.5234

gregg.noel@skadden.com

Palo Alto Office

Thomas J. Ivey

650.470.4522

thomas.ivey@skadden.com

Washington, D.C. counsel Andrew J. Brady and Chicago counsel Benjamin R. Foster assisted in the preparation of this memorandum.