

The Not-So-Quiet Period: How Statements During the Registration Period Can Halt an Initial Public Offering

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The search engine developed by Google Inc. is famous for its thorough search results. Interestingly, though, it does not have a direct link to one of the most talked-about initial public offerings (IPOs) in recent memory. After filing its registration statement, Google went out of its way to avoid discussion of its upcoming IPO. This may appear counterintuitive, as a highly publicized IPO almost certainly would increase public demand for the offering and drive up the price of its shares.

The reason for this apparently odd behavior is the existence of Rule 134 of the Securities Act of 1933 under which the term “quiet period” was coined. The quiet period is the time between the date of registration with the SEC and the effective date of the offering. During the quiet period, the Act limits what a company going public can say. However, it is unclear which statements are acceptable and which are prohibited. The present guideline for acceptable statements is “announcements in the ordinary course of business.”

The purpose of the quiet period is to provide potential investors with uniform information about the company while assuring that the company is held accountable for the assertions it makes about itself. Many companies have avoided potential liability by shutting down all forms of public announcements, choosing to refer all inquiries to the prospectus on file with the SEC.

With all of the precautions Google appeared to be taking, it still may have violated the quiet period restrictions. A week before filing the registration statement, Google co-founders, Larry Page and Sergey Brinn, were interviewed by *Playboy Magazine*. In the article, which was released during the Quiet period, they were quoted as saying: “We think we’re an important company, and we’re dedicated to doing this over the long term. We like being independent.” These seemingly routine comments caused great concern about the impending IPO. However, the SEC took no action in the matter and has therefore left many wondering whether or not Google violated the quiet period.

As if the restriction itself was not confusing enough, the penalty that may be assessed by the SEC for a violation is uncertain as well. This may be due to the fact that many companies in registration are unnecessarily sensitive to a possible violation of the quiet period and therefore say absolutely nothing. The problem with this philosophy is that in order to compete companies must use marketing and advertising. Competition is fierce and the failure to publicize new product releases or enhancements, new clients and growth of the business for the length of the quiet period—generally four to eight months—can be of great detriment to a company.

There are essentially two penalties for violation of the quiet period. The first penalty, rarely utilized by the SEC, is the imposition of a “cooling-off period.” This is an extension of the quiet period imposed

by the SEC upon violation. The SEC can refuse to declare the registration statement effective on the anticipated day. This extends the quiet period and renders moot the inside information by making it public.

Second, shareholders who purchased shares in reliance on information disseminated in violation of the quiet period may bring suit against the corporation within one year of the IPO. Upon the conclusion of a successful suit, the issuer may be forced to rescind the transaction and repurchase the plaintiff’s shares at the original purchase price.

A cooling-off period can have a seriously damaging effect on an IPO. Fortunately for Google, the SEC never ruled on whether or not the *Playboy* interview was a violation. This failure to rule may be due to several factors. First, what may be said during the quiet period is unclear and whether or not the interview was a violation is questionable. Second, the co-founders made two important amendments to their prospectus after circulation of the *Playboy* article. First, they added the text of the article to their prospectus, making the information available to all investors. Second, they explained that should the interview be determined to be a violation of the Act, Google would be required to repurchase shares sold in the auction.

A similar issue arose in the Salesforce.com IPO scheduled for early 2004. During the quiet period, The New York Times published an article about Salesforce.com. The CEO of the company was interviewed for the article. Although much of the content of the article was in the prospectus, some facts were presented without the accompanying risk factors highlighted in the prospectus. As a result, the Salesforce.com IPO was delayed to permit a cooling-off period in order to allow any hype created by the article to fade.

After intense publicity of the quiet period, caused by the Google/*Playboy* interview, there is a movement to update this regulation. This is not the first attempt at amendment. In 1998, the SEC released its “Aircraft Carrier Proposal” which would have reduced the quiet period to approximately one month. It also would have permitted virtually unrestricted statements by an issuer. The idea was that a company would be free to say what it pleased so long as it timely filed all such communications with the SEC. This would facilitate the dissemination of material non-public information in a timely fashion to the investing public and place responsibility with investors. However, after heavy pressure from Wall Street, this proposal was struck down.

Companies must be cognitive of the quiet period rules and should take appropriate steps to avoid violation. Employers may be held accountable for communications made by their employees. It is imperative that employers take steps to educate their staff as to the restrictions imposed during the quiet period and establish measures aimed at ensuring compliance. Companies who follow the “ordinary course of business” guideline must recognize that it is a fuzzy line and should consult legal counsel before making any public statements during the quiet period. ~

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