Hale and Dorr LLP
2002/IPOreport

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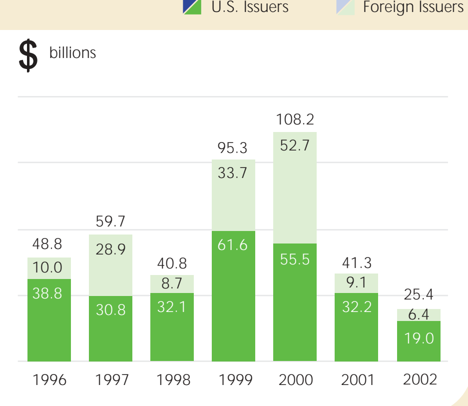
U.S. IPOs – 1996 to 2002

U.S. Issuers   Foreign Issuers



Facing the combined burden of a sluggish economy, languishing capital markets, a string of corporate and accounting scandals and the threat of imminent military confrontations overseas, the IPO market was depressed for most of the year. In 2002, there were only 75 IPOs with gross proceeds of $25.44 billion, compared to 91 IPOs raising $41.25 billion in 2001 and 446 IPOs raising $108.15 billion in 2000.

The 75 IPOs in 2002 was the lowest annual total since the 62 IPOs in 1979. As the traditional summer IPO drought stretched into fall, the IPO market experienced its longest lull in decades, without a single new offering over a ten-week period from the end of July until early October.

Average deal size declined 25% in 2002, from $453.3 million in 2001 to $339.2 million, primarily because of a decline in the number of multi-billion dollar IPOs from 11 to five. However, the average deal size in 2002 remained well above the 1999-2000 average of $207.0 million, as offerings by larger and more mature companies continued to supplant start-up company IPOs.

IPOs by U.S. companies declined 14%, from 77 in 2001 to 66 in 2002, and gross proceeds from U.S. issuer IPOs declined 41%, from $32.19 billion in 2001 to $19.03 billion in 2002. With only three billion-dollar offerings by U.S. companies in 2002, led by consumer finance giant CIT Group ($4.60 billion) and insurance company Travelers Property Casualty ($3.89 billion), the average U.S. deal size fell to $288.3 million in 2002 from $418.1 million in 2001.

For the first time since 1998, the number of IPOs by companies in the eastern U.S. (east of the Mississippi River) outnumbered those by companies in the western U.S. In 2002, there were 34 eastern U.S. IPOs—including the four largest domestic IPOs of the year—raising $15.59 billion, compared to 32 western U.S. IPOs raising $4.44 billion. California topped the state charts with 15 IPOs, followed by New York (8 IPOs) and Virginia (6 IPOs), the latter indicative of increased interest in national security, government contracting and defense-related companies.

The percentage of technology-related IPOs declined from 45% of all IPOs in 2001 to 37% in 2002, and their proceeds declined from 28% to 25% of total IPO proceeds. Offerings by consumer products companies accounted for 20% of 2002's IPOs, reflecting the sustained strength of consumer spending, followed by financial services and insurance companies (19% of the total) and medical and health care-related companies (13%).

The increased seasoning of IPO companies and the shift away from technology company IPOs is also evident in the listing choices of IPO companies. In 2002, 53% of all IPOs were listed on NASDAQ and 45% were listed on NYSE. In contrast, in both 1999 and 2000, 88% of companies going public debuted on NASDAQ. The NYSE had only 9% of new listings in 1999 and 11% in 2000.

Venture capitalists—who depend on IPOs as one of their two principal means of liquidity—were again battered by the IPO market in 2002. The year produced 19 IPOs by venture-backed companies, compared to 21 in 2001 and a whopping 200 in 2000.

As a percentage of all U.S. issuer IPOs, venture-backed IPOs edged up from 27% in 2001 to 29% in 2002, but remained far short of the 59% in 2000.

With Wall Street extending its downward trend for another year—the first three-year losing streak since 1939-1941—the average IPO in 2002 outperformed the market by a wide margin. While the Dow declined 17% during the year and the NASDAQ 32%, the average IPO in 2002 was trading a scant 1% below its offering price at year end. In a favorable signal for the 2003 technology IPO market, the average technology-related IPO from 2002 was trading 4% above its offer price at year end. The best-performing sector (based on average year-end gain from offer price) was IT systems and services providers, ending the year with an average gain of 32%.

The biggest first-day gainers of the year were Jetblue Airways and PayPal (since acquired by eBay), increasing 67% and 55%, respectively, on their first trading days. By year end, the biggest winner was technology-based educational products company Leapfrog Enterprises, trading 93% above its IPO price, followed by global outsourcing and consulting firm Hewitt Associates (up 67%) and retailer Dick's Sporting Goods (up 60%). ■

We believe that innovation will remain a driver of long-term economic growth, and that the long-term prospects for many technology and life sciences companies in the wireless, software, biopharmaceuticals, medical devices and health care industries are bright. By historical measures, the ebullient IPO market of the late 1990s was as aberrational as the tepid IPO market of 2001 and 2002. Although we do not anticipate a return to the IPO market conditions of 1999 and 2000 any time soon, we do expect the IPO market to improve in 2003. Many factors will determine the extent of its recovery.

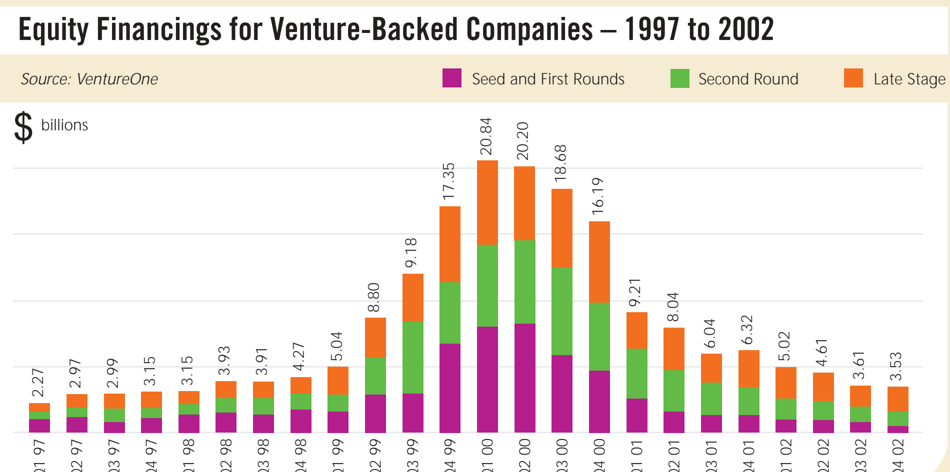
Capital Market Conditions

Stability and strength in the capital markets have long been a precursor of activity in the IPO market. The Dow Jones Industrial Average declined 16.8% for the year and the NASDAQ composite index dropped 31.5%, putting it nearly 75% below its March 2000 peak. After cutting short-term interest rates 12 times in two years, from 6.5% at the start of 2001 to 1.25%—the lowest level in four decades—the Federal Reserve Bank has little room left to stimulate the economy. A nascent fourth quarter market rally petered out at year end, as the Dow turned in its worst December performance since 1931.

Still, there are some signs of recovery on the horizon. After pulling more than $26 billion out of stock mutual funds in the first ten months of the year, investors plowed $6.5 billion back into the market in November, according to the Investment Company Institute. In the battered tech sector, bargain prices appear to have attracted some interest, as the Dow Jones Technology Index rose 29% by year end from its early October low. With improving earnings, many stocks now sport attractive price-earnings ratios that are in line with historical levels.

Economic Growth

Economic growth will be a key determinant of market strength in 2003. Fueled by the technology sector, the U.S. economy enjoyed a remarkable ten-year period of growth that finally sputtered to an end in early 2001. The economy recovered in fits and starts in 2002, largely on the back of strong consumer spending and in spite of sharp declines in business investment.



The general consensus appears to be that the economy will strengthen in 2003, although optimism is tempered by concerns over the possibility of war with Iraq, further terrorist attacks and increased petroleum prices. The main drivers of growth are expected to be:

- ***Business investment:*** After several years of parsimony, aging equipment and systems need to be replaced, funded by improved profitability from cost-cutting and productivity gains. Forrester Research predicts that U.S. technology spending will grow 5.6% in 2003, returning to 1998 levels after plunging by nearly 30% from 2000 to 2002.
- ***Consumer spending:*** With strong income growth and rising house values, and a possible boost from proposed tax cuts, consumer spending should continue to fuel the economy.
- ***Federal government:*** Economic stimulus proposals and increased government spending and investment relating to homeland security should also contribute to economic growth.

Investor Confidence

Investor confidence was roiled by a slew of corporate and accounting scandals in 2002 and further eroded by revelations of analyst misbehavior and conflicts of interest in investment banking practices. A belief in the fundamental integrity of the capital markets is necessary for any securities market, including the IPO market, to prosper.

New federal legislation and new rules from the SEC and major stock exchanges—coupled with the absence of new, major scandals—suggest that the worst is behind us, although the disclosure world that new IPO companies face is vastly different than it was just one year ago. (Please see the article beginning on page 10 for a discussion of the new disclosure environment.)

Availability of IPO Candidates

The 2003 IPO market is likely to continue to be populated by more seasoned companies. Experienced management, substantial revenue and profitability, superior products or market positions and strong growth and earnings prospects will be the hallmarks of most successful IPO companies.

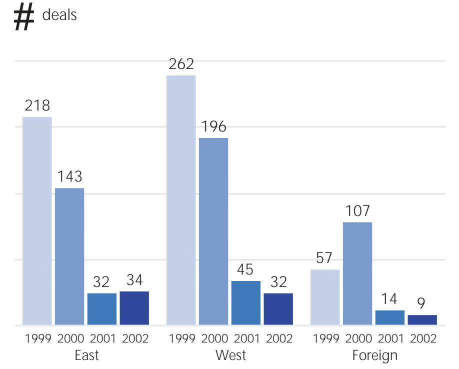
Ironically, the pool of candidates has been depleted because many established companies that would ordinarily have gone public in 2003 launched IPOs as younger companies in 1999 and 2000. Many late-stage venture-backed companies have now been left on the IPO doorstep, and the pipeline of innovative start-ups—future IPO candidates—has slowed. According to VentureOne, U.S. venture capitalists allocated only 30% of their overall funding to seed and first financing rounds in 2002.

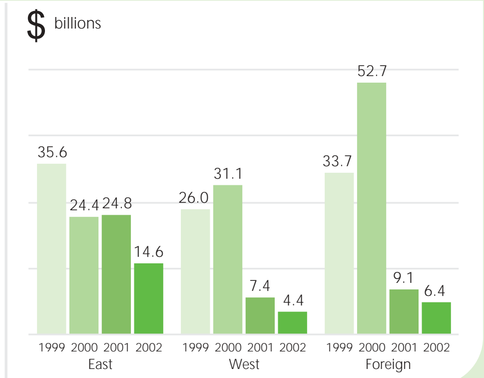
It remains to be seen whether the new disclosure environment facing all public companies—and the unprecedented focus on corporate governance and management issues—will deter some viable candidates from going public in 2003. ■

In 2002, 34 IPOs (45% of the total) were by companies based in the eastern U.S. (east of the Mississippi River)—an increase from 32 IPOs in 2001. IPOs by western U.S.-based companies declined to 32 (43% of the total) in 2002 from 45 in 2001. The remaining nine IPOs (12% of the total) were by foreign companies—a decrease from 14 IPOs in 2001.

Buoyed by the $4.6 billion IPO of CIT Group and the $3.89 IPO of Travelers Property Casualty, eastern U.S. IPOs raised $14.59 billion (57% of the total). Western U.S. IPOs raised $4.44 billion (17%) and foreign IPOs raised $6.41 billion (25%) of the year's IPO proceeds. ■

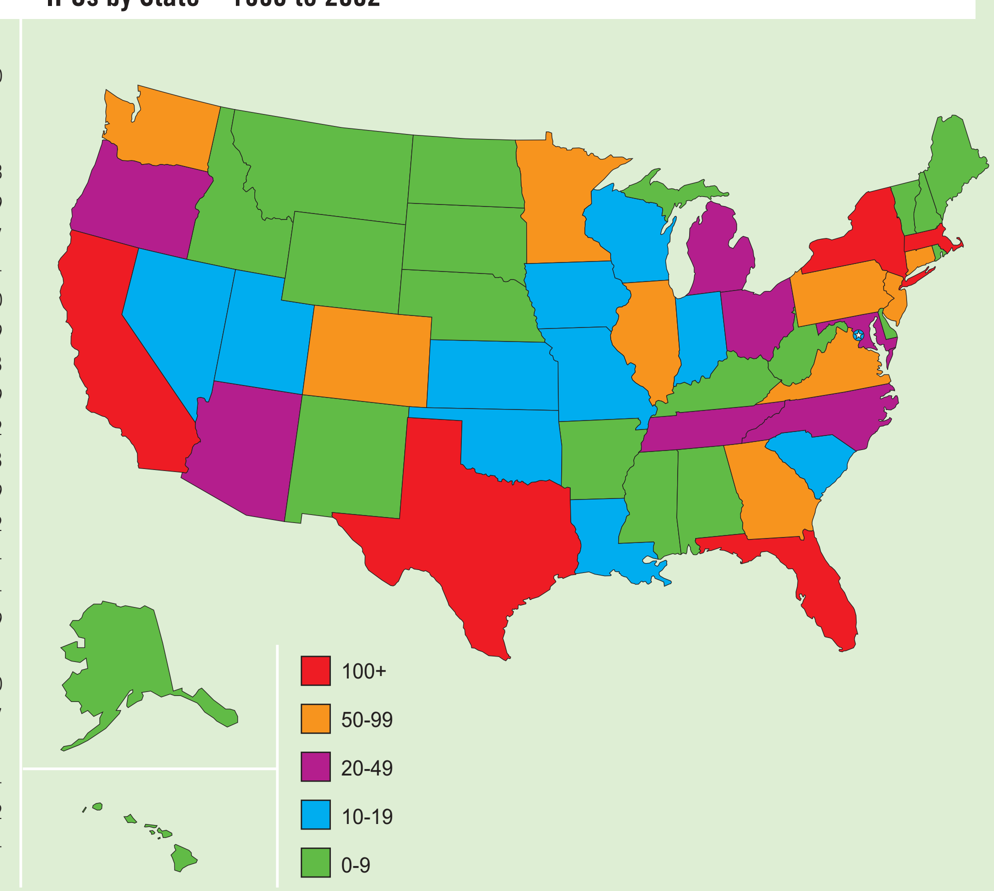
East, West and Foreign IPOs – 1999 to 2002





IPOs by State – 1996 to 2002

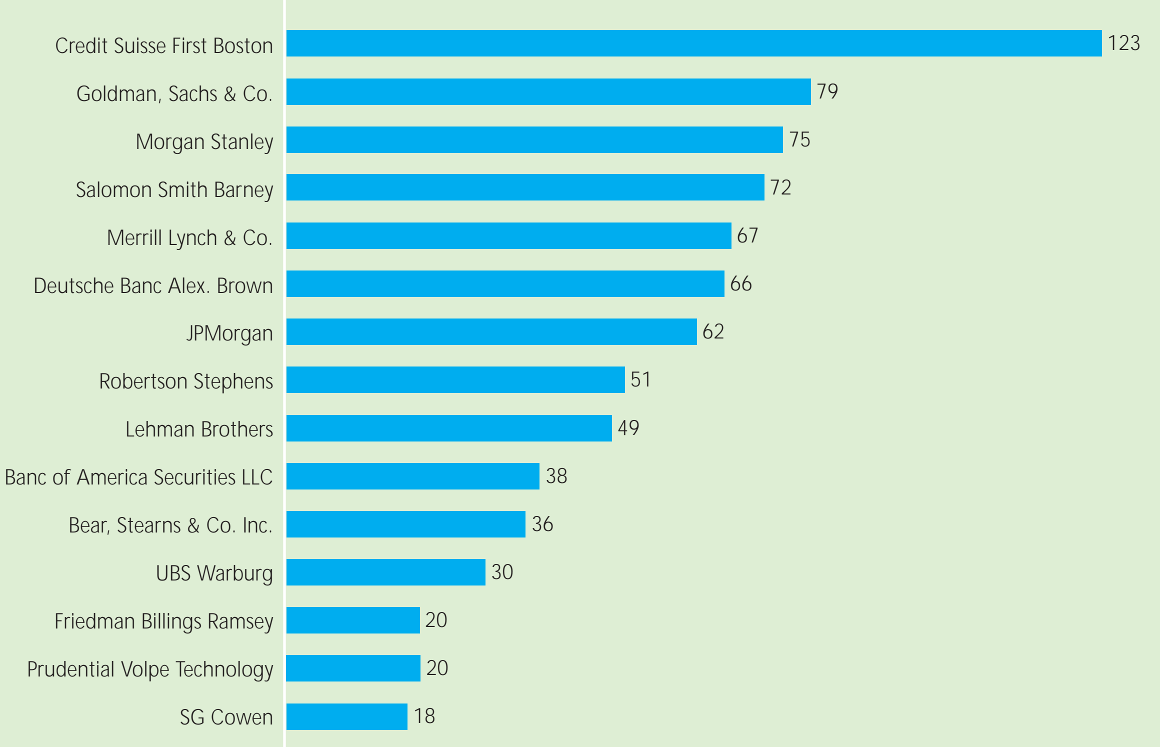
State	#	$ millions	State	#	$ millions
AK	1	140.0	MT	1	40.0
AL	6	310.9	NC	31	1,569.1
AR	4	168.0	ND	2	113.1
AZ	34	1,793.0	NE	5	259.8
CA	692	48,938.7	NH	9	402.9
CO	77	5,278.2	NJ	85	10,388.7
CT	53	10,175.6	NM	5	678.4
DC	15	1,397.0	NV	10	688.0
DE	4	505.9	NY	242	39,489.9
FL	155	9,478.8	OH	40	2,785.3
GA	72	10,530.0	OK	17	2,565.9
HI	2	60.5	OR	25	1,676.2
IA	12	2,673.8	PA	82	10,230.3
ID	2	62.5	RI	7	565.9
IL	82	16,716.2	SC	10	565.2
IN	18	2,825.3	SD	1	6.4
KS	12	904.2	TN	24	1,452.4
KY	8	959.2	TX	209	24,883.9
LA	11	635.1	UT	15	701.1
MA	152	12,770.3	VA	76	8,509.0
MD	49	5,497.3	VT	2	131.7
ME	6	752.5	WA	69	15,036.1
MI	32	3,278.7	WI	15	945.4
MN	55	2,638.6	WV	2	125.2
MO	18	6,817.8	WY	1	8.4
MS	5	310.1			



Law Firm Ranking – 1996 to 2002

Law Firm	Counsel to Issuer	Counsel to Underwriters	Total
Hale and Dorr LLP	57	69	126
Testa, Hurwitz & Thibeault, LLP	23	65	88
Skadden, Arps, Slate, Meagher & Flom LLP	29	38	67
Cravath, Swaine & Moore	9	51	60
Davis Polk & Wardwell	5	52	57
Brobeck, Phleger & Harrison LLP	23	33	56
Morgan, Lewis & Bockius LLP	37	12	49
Shearman & Sterling	10	38	48
Latham & Watkins LLP	15	28	43
Ropes & Gray	6	37	43
Greenberg Traurig, LLP	25	13	38
Simpson Thacher & Bartlett	12	26	38
Dewey Ballantine LLP	9	26	35
Piper Rudnick LLP	17	17	34
Goodwin Procter LLP	20	13	33

Lead Underwriter Ranking – 1996 to 2002



$103,500,000
May 2002

$352,439,000
April 2000

$234,000,000
October 1999

Switchboard
$94,875,000
March 2000

$136,850,000
September 2000

MILLENNIUM
$62,100,000
May 1996

$69,000,000
July 1999

$109,250,000
March 2000

$168,000,000
February 1999

$67,280,000
May 1999

$55,200,000
August 1999

€672,000,000
March 2000
Counsel to Lycos

$104,650,000
March 1999

$39,100,000
June 1995

$188,370,000
May 2000

$49,910,000
January 2000

$62,891,000
March 1998

$284,050,000
October 1999

$195,500,000
March 2000

$77,280,000
November 1999

$72,450,000
August 1998

$60,375,000
January 2000

$82,881,000
November 1995

$122,400,000
November 1999

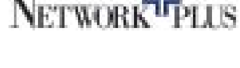
$77,625,000
July 2000

$110,400,000
August 1998

$142,907,000
August 1998

$59,800,000
August 2000

RSA SECURITY
$40,480,000
December 1994



$147,200,000
June 1999

$57,500,000
November 1995

Engage
$103,500,000
July 1999

$82,800,000
October 1997

$55,200,000
December 1995

$137,215,000
December 1995

$50,830,000
February 1999

$127,075,000
July 2000

$279,450,000
June 2000

IF YOU'RE GOING PUBLIC > >> GO WITH THE IPO LEADER.

DWDM
SPIDERING
BIOCHIPS
DNA COMPUTING
FUSION PROTEINS
WIRELESS LAN
INTELLIGENT AGENTS
OPTICAL NETWORKING
EXTREME ULTRAVIOLET LITHOGRAPHY
NEURAL NETWORKS
BIOPHARMACEUTICALS
PHOTONICS
BIOINFORMATICS
NANOTECHNOLOGY
QUANTUM COMPUTING
MEMS
PHARMACOGENOMICS

New England

New England—and especially Massachusetts—has historically produced a large number of IPOs and one of the highest concentrations of technology-related IPOs in the country. However, with technology companies largely out of favor with investors, the number of IPOs in the region has dwindled over the past two years.

New England generated five IPOs with gross proceeds of $5.46 billion in 2002, up from three IPOs with gross proceeds of $1.02 billion in 2001. The bulk of the year's proceeds came from Travelers Property Casualty, whose IPO produced $3.89 billion—the second largest domestic IPO of the year. New England had no technology-related IPOs in 2002.

We expect a revived level of activity in the New England IPO market in 2003 as capital market conditions and the climate for technology companies improve. New England's large number of world-renowned universities and research institutions, strong network of venture capitalists and other service providers and numerous established technology and life sciences companies ensure the region will remain a vibrant center for emerging companies.

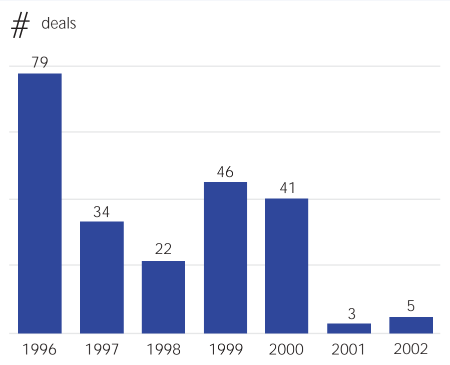
Tri-State

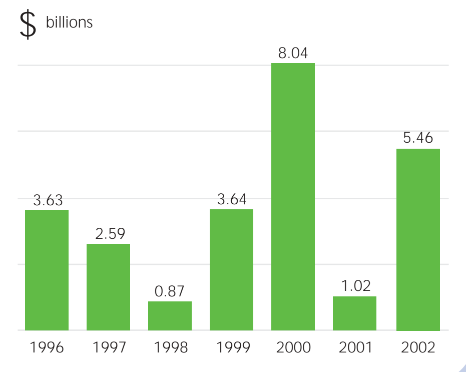
The tri-state region of New York, New Jersey and Pennsylvania continues to be one of the most active regions for IPOs in the country, trailing only California in 2002. The region remains a diversified source of IPOs, with its 2002 offerings reflecting the region's strengths in the financial services, pharmaceuticals, health care and software industries.

In 2002, the region produced 13 IPOs with gross proceeds of $7.07 billion—down slightly from 14 IPOs with gross proceeds of $9.35 billion in 2001. Over 65% of the tri-state region's gross proceeds in 2002 came from CIT Group, whose IPO produced $4.6 billion—the largest domestic IPO of the year.

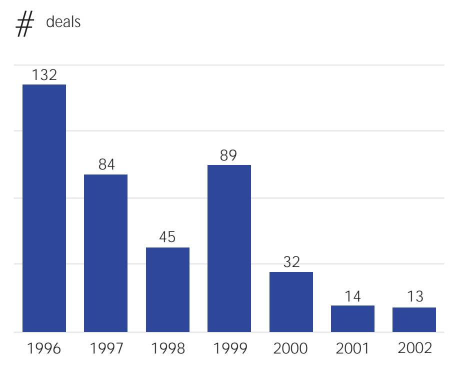
For 2003, we anticipate that the tri-state region will continue to produce a sizable percentage of all U.S. IPOs. As the IPO market becomes more hospitable to emerging technology companies, we expect to see offerings by some of the increasing number of venture-backed companies in the region.

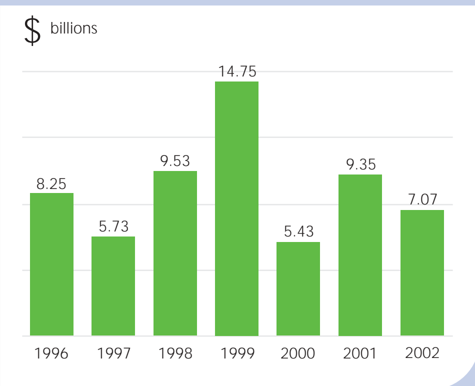
New England IPOs – 1996 to 2002





Tri-State IPOs – 1996 to 2002





Mid-Atlantic

The mid-Atlantic region of Virginia, Maryland, North Carolina, the District of Columbia and Delaware produced seven IPOs with gross proceeds of $959 million in 2002, compared to five IPOs with gross proceeds of $2.75 billion in 2001 (of which $2.02 billion came from KPMG Consulting's IPO).

The beneficiary of increased interest in national security, government contracting and defense-related companies, Virginia produced six IPOs—all but one from this industry sphere. The other mid-Atlantic IPO in 2002 was by North Carolina-based Inveresk Research Group, a provider of drug development services.

With continued investor interest in federal government IT services contractors and defense-related companies, we expect the region will continue to produce attractive IPO candidates in 2003. We also anticipate that the equity markets will continue to remain receptive to offerings by promising life sciences and medical devices companies—another area of strength for the mid-Atlantic region and particularly for the Research Triangle area of North Carolina.

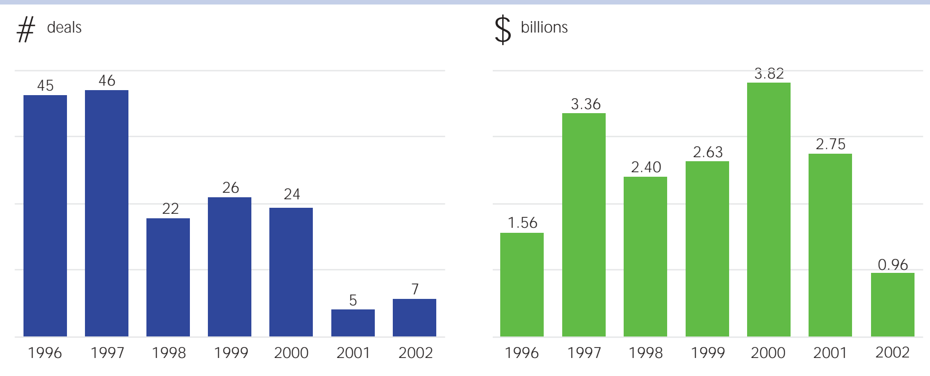
International

Despite a decline in the favorable valuations that were available to foreign issuers on U.S. markets throughout the late 1990s, IPOs by foreign companies remained an important part of the U.S. IPO market in 2002.

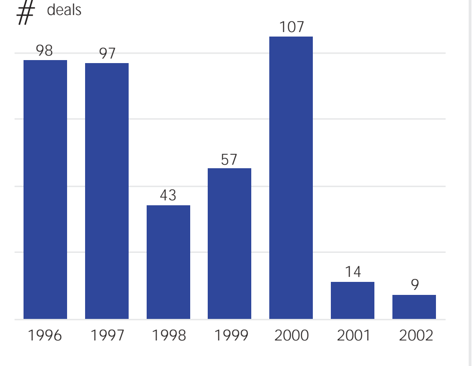
In 2002, there were nine IPOs by foreign issuers with gross proceeds of $6.41 billion, compared to 14 IPOs by foreign issuers with gross proceeds of $9.06 billion in 2001. The largest foreign-company IPOs of the year were from Swiss eyecare products company Alcon ($2.30 billion) and China Telecom ($1.43 billion). Since 1996, IPOs by foreign companies have accounted for 14% of all IPOs and 36% of all IPO proceeds.

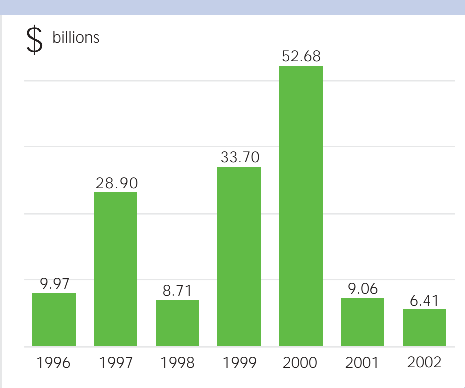
With many overseas markets still developing and trailing the U.S. in liquidity, we anticipate 2003 will continue to see a steady flow of foreign IPOs, including offerings by denationalized monopolies and some large telecommunications providers. It remains to be seen whether heightened disclosure requirements will deter companies from listing on U.S. markets. ■

Mid-Atlantic IPOs – 1996 to 2002



Foreign Company IPOs – 1996 to 2002





Entering 2002, we knew that the environment in which public companies operate was going to change, as the SEC—through "cautionary advice," other interpretive guidance and press releases promising future rule proposals—reacted to unfolding news of financial fraud and corporate misconduct.

No one could have anticipated, however, how the pace of change would dramatically accelerate over the summer. New scandals, mixed with the dynamics of upcoming national elections, culminated on July 30 in the Sarbanes-Oxley Act—the most far-reaching legislation affecting the federal securities laws since they were created in the 1930s.

As we enter 2003, the requirements and uncertainties of the Sarbanes-Oxley Act, combined with a sincere effort by senior executives and boards of directors to restore investor confidence, aggressive enforcement initiatives by various regulators, proliferating corporate governance rating systems and increased institutional shareholder activism, are continuing to contribute to a rapidly changing disclosure, corporate governance and liability environment for public companies.

The New Disclosure Environment

Perhaps no aspect of last year's changes was more dramatic than the new requirements for CEOs and CFOs to personally certify their companies' annual and quarterly reports. While one can debate the extent to which the new certification requirements actually changed existing liability, the new requirements clearly altered the mindset with which most CEOs, CFOs and their companies approach SEC reporting. Companies are now introducing and updating a wide range of processes designed to ensure that information is identified and disclosed in a timely and accurate manner.

The SEC codified the need for these processes through new rules requiring public companies to maintain "disclosure controls and procedures"—that is, controls and other procedures designed to ensure that information required to be disclosed in SEC reports is assimilated and processed within the required time periods—and to periodically evaluate them and report on their effectiveness.

The SEC has proposed similar rules regarding "internal controls and procedures for financial reporting"—that is, controls regarding the preparation of financial statements for external purposes that are fairly presented in conformity with GAAP. The company's auditors will be required to attest to management's annual internal controls report.

While the new controls and procedures are intended to improve the overall quality of disclosures made by public companies, they are perhaps most important for identifying items that must be addressed in MD&A, the management's discussion and analysis of financial condition and results of operations.

MD&A is the centerpiece of a company's SEC reports. Not surprisingly, a large number of new disclosure rules and proposals center on MD&A: identification and explanation of critical accounting policies; increased disclosure about off-balance sheet transactions and contingent liabilities; and mandatory tabular presentation of contractual obligations.

Other recent or upcoming changes to the disclosure environment include:

- a requirement, in effect since August 29, 2002, that most insider stock transactions be reported within two business days after the transaction;
- the acceleration of filing deadlines for annual and quarterly reports, which over the next three years will require seasoned companies to file their 10-Ks in 60 days and 10-Qs in 35 days;
- a proposed expansion of the items required to be reported on a current basis on Form 8-K, including the entry into material agreements, the loss of business from significant customers, changes in credit ratings and changes in directors and officers;
- a proposed requirement that 8-Ks must be filed within two business days after the event, as compared to the existing deadlines that range from five business to 15 calendar days;
- new rules regulating the use of non-GAAP financial measures in any public disclosure, including a more restrictive set of rules that applies to SEC filings;
- new California state regulations requiring public companies incorporated or qualified to do business in California to file information about the backgrounds and compensation of executive officers and directors that differs from the information required by SEC rules; and
- a requirement that the SEC review each public company's SEC filings at least once every three years.

The New Corporate Governance Environment

NASDAQ and the NYSE have each proposed rules relating to the composition of boards of directors and board committees, responsibilities of board committees and other corporate governance matters. When combined with the new audit committee requirements contained in the Sarbanes-Oxley Act, these new requirements will lead many companies to seek new directors and to fundamentally update their board practices.

Proposed NASDAQ and NYSE rules require that at least a majority of the directors be "independent." The proposed definition of "independent" varies between the two stock markets, but each definition excludes current and former (within the past three to five years) employees, relatives of executive officers, present or former (within the past three to five years) employees of the company's auditor, and employees of another company whose compensation committee includes an executive officer of the company.

Independent directors will be required to meet in executive session without company management, and committees consisting solely of independent directors will bear exclusive responsibility for a number of duties.

The Sarbanes-Oxley Act imposes heightened requirements for audit committee composition and imposes additional responsibilities on the committee. In addition, there are proposed and current NASDAQ and NYSE rules imposing additional duties on audit committees.

- ***Independence.*** The Sarbanes-Oxley Act, NASDAQ and the NYSE each require that all members of the audit committee be "super independent." In order to be

eligible to serve on the audit committee, a director must not accept any consulting, advisory or other compensatory fees from the company (other than director fees) or be an affiliate of the company. Share ownership at a level above 10% may result in a director being deemed an affiliate and therefore unable to serve on the audit committee. NASDAQ and the NYSE further require that audit committee members satisfy the independence test applicable to board members.

- ***Financial Expertise.*** Current NASDAQ and NYSE rules require all audit committee members to be financially literate and at least one member to have accounting or financial management experience. The Sarbanes-Oxley Act requires companies to disclose in their Form 10-Ks whether the audit committee contains at least one member who is an "audit committee financial expert." While the final definition of "audit committee financial expert" adopted by the SEC is not as restrictive as initially proposed, it still raises the bar from current standards.

- ***Oversight of Auditors.*** The Sarbanes-Oxley Act has given audit committees the direct and sole responsibility for the appointment, compensation and oversight of the company's auditors. This includes pre-approving any services, audit or non-audit, to be provided by the auditors. Other new or proposed provisions relating to the auditors include:
  - a ban on most non-audit services from the company's auditor, including bookkeeping, appraisals, valuations, financial information systems design and implementation, investment advisor services, actuarial services, fairness opinions and human resource services, although tax services generally are still permitted;
  - a requirement to rotate key audit firm partners who work on the company's audit;
  - a loss of audit firm independence if any of certain enumerated executives of the company is a former employee of the audit firm who worked on the company's audit during the past year; and

Pre-IPO Planning after Sarbanes-Oxley

Pre-IPO planning just got a lot harder. While the Sarbanes-Oxley Act and new stock market rules do not generally cover private companies, a private company will become subject to the Sarbanes-Oxley Act upon filing a registration statement with the SEC in anticipation of an IPO.

Here are some of the key things pre-IPO companies now need to do:

> **Officer and Director Loans:** Consider prohibiting all officer and director loans, or requiring that any loans made or modified after July 29, 2002 be repaid immediately prior to the filing of the IPO registration statement if at that time the borrower is a director or executive officer of the company.

> **Stock Plans:** Evaluate whether the number of shares covered by the employee stock option plan needs to be increased and whether any new stock plans, such as a director stock option plan or an employee stock purchase plan, should be adopted—*prior* to the IPO.

> **Board Independence:** Ensure that a majority of directors are independent.

> **Audit Committee:** Ensure that (1) all members of the audit committee are independent, (2) at least one member of the audit committee is an "audit committee financial expert" (or be prepared to explain why not), (3) the audit committee has direct and sole responsibility for the appointment, compensation and oversight of the company's auditors and (4) the audit committee has established procedures for receiving and handling accounting complaints.

> **Compensation Committee:** Ensure that the compensation committee consists solely of independent directors.

> **Nominating Committee:** Ensure compliance with the applicable NASDAQ or NYSE rules for director nominations and nominating committees.

> **Non-Audit Services:** Make arrangements for receiving prohibited non-audit services from suppliers other than their auditors following the filing of the registration statement.

> **Rotation:** Depending on the timing, be prepared for audit, review or other participating partners to rotate off the company's account.

> **Hiring Restrictions:** Avoid hiring a CEO, CFO, chief accounting officer or controller (or another person in a "financial reporting oversight role") from the company's accounting firm during the year before filing the registration statement.

> **Disclosure and Internal Controls:** Establish appropriate controls and procedures to withstand underwriter due diligence and avoid the need to substantially re-engineer business processes following the IPO.

  - limitations on the ability of audit partners to be compensated based on non-audit services provided by the partner's firm.

- ***Other Responsibilities.*** The Sarbanes-Oxley Act requires that a company's audit committee adopt and implement procedures for receiving and handling complaints regarding accounting matters, including the confidential and anonymous submission of employee concerns regarding accounting matters; receive certain specified reports from the auditors, including information about the company's critical accounting policies; and have authority to retain and compensate outside advisors. The NYSE has proposed that audit committees oversee the company's internal audit function; review risk management policies; review interim financial statements; and review generally the company's earnings releases and other financial disclosures. NASDAQ audit committees will be required to review and approve all related party transactions.

NASDAQ has proposed that director nominations and executive officer compensation must be approved either by a committee comprised of independent directors or by a majority of the independent directors. The NYSE has proposed requiring that each listed company have a nominating and corporate governance committee and a compensation committee, each comprised solely of independent directors. The NYSE has also detailed certain of the responsibilities of these committees, which include oversight of annual board evaluation processes and establishing annual goals for the CEO.

Under adopted SEC rules and NASDAQ and NYSE proposals, companies will need to have and to publicly disclose codes of conduct and ethics covering topics such as: compliance with laws; ethical handling of conflicts of interest; full, fair, accurate, timely and understandable disclosure; and accountability for adherence to the codes. Any waiver of these codes as applied to an executive officer or director would require prompt public disclosure.

The NYSE has proposed a requirement that companies adopt guidelines addressing: director qualifications and responsibilities; director access to management and advisors; director compensation, orientation and continuing education; and management succession.

The NYSE and NASDAQ have both proposed rule changes that would require shareholder approval of almost all plans covering compensatory issuances of equity securities. In addition, the NYSE has proposed a prohibition on discretionary voting by brokers on stock plans, with brokers instead permitted to vote customer shares on stock plan proposals only pursuant to customer instructions. Although this is an NYSE rule, it affects NASDAQ companies as well, since it would apply to voting by all brokers and dealers that are members of the NYSE, regardless of where the shares being voted are listed.

The New Liability Environment

The Sarbanes-Oxley Act prohibits some previously common practices. Most notably, the Act prohibits a public company from directly or indirectly extending or maintaining credit, or arranging for or renewing the extension of credit, in the form of a personal loan, to any director or executive officer. The Act's prohibition does not apply to loans that existed on July 29, 2002, so long as no material modification or extension is made. The impact of this new law in several areas, including cashless exercises of stock options, is still unclear. The Act also prohibits directors and officers from trading company securities during certain pension plan blackout periods.

The Sarbanes-Oxley Act increased the penalties for a number of existing securities-related crimes. The CEO and CFO at a company that restates its financial results due to "misconduct" may be required to disgorge all incentive- and equity-based compensation received during the 12 months after faulty financials were made public, and all profits realized from their sale of their employer's securities during that period. Criminal penalties for securities fraud violations and false certifications now range as high as $10 million and 25 years imprisonment. Moreover, debts arising from claims that result from violations of securities laws can no longer be discharged in bankruptcy.

The Sarbanes-Oxley Act also created several new crimes: retaliation against whistleblowers; destruction of documents and other obstruction of justice offenses; fraudulently influencing the company's auditors; and a new substantive securities fraud offense with penalties that are more punitive than those available for other serious white collar offenses.

The Act has significantly increased the SEC's arsenal of enforcement tools and remedies, including the new ability to freeze "extraordinary" payments being made by a company under investigation to its directors and officers and the power, through administrative procedures rather than a court proceeding as previously required, to bar an individual from future service as an officer or director of a public company.

On the private litigation side, the Act extended the statute of limitations for some securities fraud lawsuits to the earlier of two years after discovery of the facts constituting the violation or five years after the violation (replacing the prior one year, three year rule).

Finally, the Sarbanes-Oxley Act contains important provisions affecting:

- public accountants, whose industry will be regulated by a new Public Company Accounting Oversight Board;
- securities analysts, who—due to the combined effects of the Act's provisions, new rules adopted by NASDAQ and the NYSE and the various litigation settlements being entered into by investment banks—will face significant changes in the way analyst research is performed; and
- attorneys, who for the first time are facing substantive federal regulation of their conduct as the SEC adopts minimum standards of professional conduct for attorneys.

The full effects of the new environment will not be known for years to come. But one thing is certain: the world faced by new public companies is dramatically different than that encountered by IPO companies a mere 12 months ago. ■

Want to know more about the 2002 venture capital market and 2003 outlook?

Please see our companion publication, the *2002 Venture Capital Report*, for analysis and regional breakdowns, as well as important information on corporate governance reforms that affect private companies and key issues in the sale of venture-backed companies.

To request a copy of the *2002 Venture Capital Report*, contact marketing.department@haledorr.com or call 617 526 5600.

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Data Source

Hale and Dorr LLP compiled all data in this report unless otherwise noted. Offerings by REITs, bank conversions and closed-end investment trusts are excluded. Offering proceeds exclude proceeds from exercise of underwriters' over-allotment options, if applicable. The IPO data is collected from various sources, including IPO.com, IPOCentral.com, SEC filings and the Washington Service Bureau. For lead underwriter rankings, IPOs are included under the current name of each investment bank.

Internet Availability

An electronic version of this report, along with a searchable database of the data that appears in this report, can be found at www.ipoleader.com.

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