Davis Polk

IPOs and other public offerings during the government shutdown

October 27, 2025 | Client Update | 12-minute read

With the shutdown quickly moving into its fourth week, we discuss our views on key questions impacting IPOs and other capital markets transactions.

Nearly a month into the government shutdown with no clear end in sight, many companies and underwriters are starting to ask the same question: Can we still go public? The short answer is ***Yes, under the right circumstances***—and the Securities Act of 1933 gives you a legal path to do so. But there are tradeoffs you need to understand before taking the plunge.

We explained in a recent client update that ***a company with a registration statement pending before the SEC*** can complete its IPO during the shutdown by:

- filing the registration statement publicly (or filing an amendment to an already-public registration statement) without the "delaying amendment"—the confusing but seldom-noticed language at the very bottom of the cover page,
- including a price range on the cover page of the prospectus, as a company normally would,
- waiting 20 days after the filing, at which point the registration statement automatically becomes effective, and then
- pricing the IPO!

These steps are consistent with the federal securities laws and recent SEC guidance relating to capital markets transactions while the SEC is closed for business. This approach is simple for a company with no or few outstanding SEC comments. But the path is trickier for companies with a number of outstanding SEC comments, or companies who have not yet received SEC comments.

The SEC cautioned that a company with outstanding staff comments who proceeds in this manner "should carefully consider the material issues raised by the staff," and make any responsive changes to the registration statement that the company considers needed. In addition, if the filing contains significant new information that the SEC has not yet had a chance to review, it is possible that they could review it when they get back online.

So there is some risk, depending on the nature of outstanding comments or brand-new disclosure, that the SEC would review the filing (or the company's 10-Q or 10-K) after the IPO, and then issue comments that could question the company's disclosure.

If the company reasonably believes it has addressed outstanding SEC comments and does a good job of anticipating potential SEC comments on any new disclosure, this risk can be mitigated, if not entirely eliminated. The decision process is a bit more complicated for a company that has yet to receive comments—here too the risk can be mitigated, but not eliminated. In both cases, there are additional hurdles with the stock exchanges that must be overcome.

Finally, we would strongly suggest that ***a company without a pending registration statement*** file (or confidentially submit) its registration statement sooner rather than later, because when the SEC reopens they are likely to be substantially backed up, and will probably start reviewing registration statements in the order in which they were received.

IPOs

How does the path to IPO during the shutdown differ from a regular-way IPO?

Under SEC rules, underwriters cannot confirm sales of IPO stock without an effective registration statement. A registration statement is typically "declared" effective by the staff, but while the SEC is shut down, there is no staff to do this.

An alternative but little-used method for a registration statement to become effective is to rely on Section 8(a) of the Securities Act, which provides that a registration statement automatically becomes effective 20 days after filing—as long as it does not have a delaying amendment. For example, assuming a company files its registration statement before 5:30 p.m. on Day 1, it would become effective at 5:30 p.m. on Day 20.

In normal times, ripping off the delaying amendment is rarely done out of concern that the SEC could respond with a stop order if they haven't finished their review. But these are not normal times.

How do we handle the price range and IPO price?

To kick off the 20-day clock, the registration statement when filed must include a price range. In addition, the IPO price must be part of the registration statement at the time of effectiveness; this is accomplished by filing the final prospectus after pricing.

The catch is that the relevant rule, Rule 430A, on its face applies only to registration statements that are "declared" effective by the staff, creating uncertainty over whether the rule can be used with a registration statement that becomes effective automatically without staff involvement.

Fortunately, the SEC's recent guidance permits companies to rely on Rule 430A during the shutdown even for registration statements that go effective automatically. The ability to use Rule 430A means a company can price above or below the range and benefit from the familiar 20% safe harbor, just like it could in a regular-way IPO.

Also, if market conditions are not ideal for a pricing on Day 20, the company gets the flexibility under Rule 430A to price within 15 business days after Day 20.

How should we think about outstanding SEC comments or significant new disclosure?

The SEC guidance notes that "companies that remove their delaying amendment with outstanding staff comments should carefully consider the material issues raised by the staff and not remove their delaying amendments prior to making the necessary changes to the registration statement."

In addition, the guidance says that "[o]nce the SEC resumes operations, the staff may request that you amend your registration statement even if it has become effective by operation of Section 8(a)." The staff could also raise comments in its review of a subsequent 10-Q or 10-K.

The risk here is that disclosure made after the IPO could catch the eye of plaintiffs' lawyers if the stock trades off. We believe this risk is low as long as the company and the deal team are comfortable that they have thoughtfully addressed all outstanding SEC comments, and that any other changes first reflected in the public filing or amendment are updates that the company and the deal team believe are unlikely to raise significant staff concerns.

What if we have a number of comments outstanding—or we haven't even received comments?

The after-the-fact comment risk is heightened for a company in this position. We are not yet aware of IPO deal teams who have gotten comfortable launching an IPO with a substantial number of comments outstanding or without any SEC review.

And while the SEC could issue comments on the registration statement after the IPO, a more practical risk is that the shutdown ends during the 20-day period before effectiveness and the SEC issues comments (or indicates that it will issue comments after the 20-day period) while the roadshow is underway—a development that would jeopardize deal execution.

That said, if the shutdown continues to drag on, companies and deal teams may reassess the pros and cons of moving forward with an IPO even where the registration statement is still at an early stage of review—or not even reviewed at all. It remains to be seen whether the auditors will provide their consent in these situations, which would be necessary to proceed.

What if something happens during the 20-day period that requires disclosure?

If something happens during the 20-day period that warrants disclosure in the IPO prospectus, amending the registration statement to include it would restart the 20-day period.

Rather than filing an amendment, an eligible company could instead include disclosure of the material development in a free writing prospectus (FWP) filed with the SEC, and then reflect the change in the final prospectus. However, a development can only be handled in an FWP if it does not "conflict with" the information in the registration statement. What that means is a judgment call that will depend on facts and circumstances.

If the company moves forward with this approach, it would need to complete the final prospectus with pricing terms and updated disclosure immediately after pricing so that the prospectus is filed with the SEC and ready for use ***before*** any sales are confirmed (so it will be deemed to be part of the registration statement on the date it is first used after effectiveness by operation of Rule 430C). What this means in practice is a significant acceleration of the usual timetable for finalizing the prospectus.

Can we upsize the offering after effectiveness like in a regular-way IPO?

Yes, but with a change to the usual mechanics.

The SEC guidance did not address whether a company can register additional shares post-effectiveness with Rule 462(b) (the rule ordinarily used, which refers to a registration statement being "declared effective"), and we believe there are risks to relying on that rule during the shutdown.

That said, a workaround can get the company to the same place, as long as the company is OK paying an additional registration fee that it might not use. The company could register 20% more shares (and pay the correspondingly higher fee), and reflect the registration of the additional shares in the fee table filed with the registration statement.

The company should then disclose on the cover page of the prospectus (right after the description of the underwriters' option to purchase additional shares) the number of additional shares it has registered in case the company decides to increase the size of the offering after effectiveness. Similar disclosure should be included in the offering summary, the underwriting section, and the selling stockholder table when applicable.

Does moving forward during the shutdown impact legal opinions, comfort letters or other deal documents?

We don't think it should.

While minor tweaks to a legal opinion may be appropriate (like saying that the registration statement "became" effective instead of "was declared" effective), we think proceeding in the way we're discussing complies with form requirements as supplemented by staff guidance, and therefore should not require any legal opinion qualification (absent exceptional circumstances).

Similarly, we think only minimal changes should be required in an underwriting agreement to reflect automatic versus a declaration of effectiveness.

Customary underwriting agreement provisions already contemplate the approaches we're discussing (including that a final prospectus is deemed to be part of the registration statement at the time of effectiveness or on the date of first use by virtue of Rule 430A or 430C), and already include indemnities for material misstatements or omissions that cover the registration statement as supplemented by the final prospectus and any FWPs.

We don't foresee any necessary comfort letter changes.

A company must have its registration statement publicly on file for at least 15 days prior to roadshow launch. How does this interact with the 20-day period before the registration statement becomes effective?

The 15-day period begins to run when the registration statement is publicly filed. But that doesn't mean the company must wait until after the 15-day period to remove the delaying amendment and include the price range—in other words, to file the registration statement that includes the prospectus intended for IPO marketing.

For example, the company could publicly file the registration statement with a price range and without the delaying amendment on Day 1 (starting the clock on both the 15 and 20-day periods), launch the roadshow on Day 16 and price the IPO on Day 20 or 21 (or up to 15 business days after Day 20, as discussed above).

It is also fine for a company to file the registration statement with the price range fewer than 15 days after the initial public filing, as long as the company does not start the roadshow until after the 15 days expire.

How will NYSE and Nasdaq react to our use of automatic effectiveness?

In FAQs posted on October 1, Nasdaq said that it would consider listing a company with outstanding SEC comments "[i]n limited situations, where the company has substantially completed the comment process before the shutdown and acquiesces to any outstanding SEC comments in a manner that clearly addresses the SEC comment."

Nasdaq said that it would consider in its analysis, among other factors, the "materiality of the outstanding comments, the history of the company and any prior review of its filings by the SEC, and whether the company's counsel and auditor are willing to represent that they believe all disclosure and accounting comments, respectively, have been fully addressed."

In our experience company counsel has been willing to provide some form of assurance that outstanding SEC comments have been addressed. It is not clear that auditors would be willing to provide such an assurance, but it is also not clear why Nasdaq should demand it, given that the auditors must provide a consent to the use of their opinion and take liability for it.

While NYSE has not issued similar guidance during the current shutdown, it did publish FAQs in 2019 that are generally consistent with Nasdaq's recent FAQs. Based on discussions with NYSE, we believe they would be comfortable moving forward with listing with some form of assurance (like an email) from company counsel that the company has addressed outstanding SEC comments.

What if we haven't yet received SEC comments or we have significant comments outstanding?

If significant SEC comments are outstanding (or the company has not yet received comments), Nasdaq's FAQs indicated it would not list the company, though they also recognize the uncertainty caused by the shutdown and suggest they may be open to revisiting their position if it drags on. We would expect NYSE to have a similar view, based on its 2019 FAQs.

Follow-on offerings

Can we move forward with a follow-on offering during the shutdown using the same approach as an IPO, without receiving any SEC comments at all?

Yes. Whether registered on Form S-1 or Form S-3 (or the equivalent foreign private issuer form), as long as the company and the deal team are comfortable that it's unlikely the staff would review the filing even if the SEC were actually open for business, we believe the company could file the registration statement without a delaying amendment, wait 20 days to go effective and then price.

Should we include a risk factor?

Because there is some risk that the SEC could issue comments after the offering, we recommend including a risk factor in the prospectus along the following lines:

> ***Because of the ongoing government shutdown, the SEC did not complete its review of the registration statement for this offering.***
>
> *We have filed a registration statement with the SEC for this offering, but the SEC has not completed its review. During the ongoing government shutdown, the SEC will not review any registration statement or declare any registration statement effective. Our registration statement will automatically become effective on [DATE] in accordance with Section 8(a) of the Securities Act. While we believe we have satisfactorily addressed all SEC comments on the registration statement that we received before the shutdown, we could receive comments from the SEC after completion of this offering, and those comments could obligate us to modify, reformulate, add to or exclude certain information presented in this prospectus. Any such modification, reformulation, addition or exclusion could be significant. Whether or not we receive comments from the SEC, neither the SEC nor any state securities commission has approved or disapproved of these securities or determined whether this prospectus is truthful or complete.*

Such a risk factor could be tailored to particular facts—for example, if there is a particular area the SEC comments had focused on that could result in material changes to the disclosure, the risk factor could discuss that and what the changes might be.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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