Alternative Capital Raising for Public Companies

November 24, 2020

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§ 1:1 Introduction

A public company has many options beyond a traditional underwritten SEC-registered offering for cash when it raises capital in a securities offering. The company can employ various types of follow-on equity offerings, both SEC-registered and privately placed. These options include at-the-market (ATM) equity offerings, block trades, private investments in public equity (PIPEs), registered direct offerings, and rights offerings. Choosing one depends on the characteristics of the issuer, the amount of money it seeks, the amount of time it has, and the administrative requirements of each offering type. This alert memo discusses these alternative offerings and the considerations they raise under federal securities laws.

§ 1:2 At-the-Market (ATM) Offerings

§ 1:2.1 Overview

In an ATM offering, an issuer sells equity securities into an existing trading market over time at the then-prevailing market prices.[2] The issuer uses an effective shelf registration statement and one or more broker-dealers act as the issuer's agent for the sales.

[1] Sophie Grais was a summer associate at Cleary Gottlieb in 2020. Special thanks to Joon Hur and Jesse M. Brush, both former associates of Cleary Gottlieb, for co-authoring prior versions of this publication, and to Nina E. Bell and Stephanie M. Kelly for their insightful comments. This alert memo is adapted from Adam E. Fleisher & Sophie Grais, Alternative Capital Raising for Public Companies, in FINANCIAL PRODUCT FUNDAMENTALS: LAW, BUSINESS, COMPLIANCE, ch. 23 (Clifford E. Kirsch, ed., 2d ed. 2012 & Supp. 2021) (©2020 by Practising Law Institute, www.pli.edu. Reprinted with permission. Not for resale or distribution. Available at www.pli.edu/financialproductfundamentals.

[2] Rule 415(a)(4) under the Securities Act of 1933, as amended (the "Securities Act").

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An issuer may prefer an ATM offering to a traditional follow-on offering for several reasons. First, ATM programs affect an issuer's stock price less than traditional offerings because the securities are sold in small batches over time—through individual "takedowns" from the issuer's shelf—rather than all at once. The issuer can adjust the timing, size, and price of each takedown to match market conditions and demand. Because ATM offerings give issuers this kind of control, they are particularly appealing when issuers seek reliable ways to raise money in volatile markets.[3] Second, ATM programs can be less burdensome to an issuer than traditional offerings. Once the equity distribution program is in place, the issuer does not need to renegotiate terms for each offering, nor must its management team attend road shows and investor meetings each time. Third, commissions for ATM agents are typically much lower than the underwriting discounts in a traditional underwritten follow-on offering.[4]

ATM programs also have disadvantages. If an issuer wants to raise a lot of capital in a short amount of time, at a fixed price, then dribbling into the market may be neither efficient nor sufficient. In addition, though each takedown should have a minimal effect on the stock price, the creation of the program itself could create market "overhang" and depress the price. Finally, as discussed below, the ongoing due diligence requirements of ATM programs do impose some administrative burden on the issuer.

§ 1:2.3 Structure

Setting up an ATM program is similar to preparing for a traditional fixed-price underwritten public offering. The key components are the equity distribution agreement, shelf registration statement, prospectus, ongoing due diligence, and the announcement and execution of sales. First, the issuer enters into an equity distribution agreement[5] with one or more investment banks, similar to the underwriting agreement in a traditional offering. The banks agree to act as the issuer's agents to sell its equity securities into the market. They also agree to complete due diligence on the issuer periodically, while the issuer agrees to maintain an effective shelf registration statement and update its prospectus regularly. For each takedown, the issuer must provide the agents with details on price, number of shares, and timing. Each part of this process is discussed in more detail below.

[A] Equity Distribution Agreement

The equity distribution agreement defines the relationship between the issuer and the agents. It outlines how the issuer will instruct agents to make sales, how much discretion the agents have in making those sales, and how much commission the agents will earn.[6] The agreement will terminate either on a specific date or after a specified aggregate amount has been sold.

Many provisions in an equity distribution agreement are similar to those of an underwriting agreement. The agreement includes customary representations, warranties, and covenants by the issuer, conditions to offerings, and indemnification provisions. Agents in ATM programs are considered "underwriters" for purposes of the Securities Act. To bolster the agents' due diligence defense, the equity distribution agreement gives them the same protections as underwriters in a traditional offering. It requires the delivery of legal opinions and negative assurance or

[3] In 2008, ATM programs on U.S. exchanges raised $323 million. In 2009, they raised more than $18 billion. *See* Jacob Rund, *Stock Swings May Spur At-the-Market Offerings After Record High*, BLOOMBERG LAW (Feb. 12, 2018). During the COVID-19 pandemic, ATM offerings raised nearly $33 billion through August 10, 2020. *See* Preston Brewer, *Analysis: At-the-Market Offerings Rise in the Pandemic*, BLOOMBERG LAW (Aug. 14, 2020).

[4] This difference reflects the risk that the underwriters and agents assume in each case—in the traditional context, a firm commitment obligation to sell a large number of shares, as compared to a best efforts undertaking to dribble shares into the market in an ATM offering.

[5] These agreements are sometimes called "sales agency agreements" or "distribution agency agreements."

[6] The equity distribution agreement usually allows the issuer and agents to agree that the agents will act as principals (*i.e.*, on a firm commitment basis, rather than best efforts). In that case, the parties enter into a supplemental "terms agreement."

"10b-5" letters from counsel, "comfort letters" from the issuer's independent auditors, and other supporting documents. The agreement will also require these materials to be updated periodically.

[B] Shelf Registration Statement

To make ATM offers and sales, issuers rely on effective shelf registration statements, as prescribed by Rule 415(a)(4) under the Securities Act. To do an ATM offering, an issuer must therefore be eligible to use Form S-3 or Form F-3 on a primary basis. The issuer must have a public float of at least $75 million (or meet certain additional requirements); have been reporting under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for at least twelve months; and have filed its Exchange Act reports on time.[7] As discussed below, however, most issuers that use ATM programs have a public float of at least $150 million because of concerns about Regulation M.

[C] Prospectus

The shelf registration statement will include a prospectus with the terms of the securities offered and other information about the ATM program. Together, the registration statement, prospectus, and any accompanying prospectus supplement must provide detailed information about the ATM program, including the maximum size of the program (either by number of shares or aggregate gross proceeds) and the identities of the agents.[8]

As in any registered public offering, the information conveyed to investors at the time of sale is the basis of potential liability.[9] In ATM offerings, agents make sales through securities exchanges or alternative trading systems. Because there is no direct communication with investors, information must instead be disseminated publicly to the market. To avoid an offer or sale of securities while in possession of material non-public information, and to ensure it has conveyed any potentially material information to investors before a takedown, the issuer will publish a press release and file a Form 8-K (for a domestic issuer) or submit a Form 6-K (for a foreign private issuer) if needed,[10] which is incorporated into the program prospectus automatically by reference.[11] If the issuer has material non-public information that the market does not yet have, it will suspend its ATM program to prevent offers and sales until that information is disclosed.

Unlike in a traditional underwritten public offering, ATM sales are typically made in accordance with Rule 153 under the Securities Act. Under Rule 153, if certain conditions are met, a broker-dealer (an agent) is deemed to have satisfied its obligation to deliver a prospectus when effecting a transaction on a national

[7] In 2007, the SEC expanded the eligibility requirements for Forms S-3 and F-3 for primary offerings to allow an issuer with a public float of less than $75 million to use the forms, so long as the aggregate market value of securities sold by the issuer in the offering and during the preceding 12 months do not exceed one-third of the issuer's public float. *See* Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3, Securities Act Release No. 33-8878 (Dec. 19, 2007); Form S-3; Form F-3.

[8] Once the program is established, the issuer can amend the plan of distribution in the prospectus through a prospectus supplement (*i.e.,* without a need to file a post-effective amendment). For example, agents can be added or removed, and a firm commitment underwritten offering can be conducted. *See* Securities Act Rule 430B(d).

[9] For further discussion of liability considerations, see *infra* notes 41 and 42.

[10] A corporation incorporated or organized under the laws of a foreign country is a "foreign private issuer" unless (A) more than 50% of its outstanding voting securities are directly or indirectly owned by residents of the United States; and (B) (i) the majority of its executive officers or directors are U.S. citizens or residents, (ii) more than 50% of its assets are located in the United States, or (iii) its business is administered principally in the United States. *See* Securities Act Rule 405.

[11] The number of shares sold to date under the program and the net proceeds raised are generally not material to a particular takedown. The issuer, however, typically provides this information to the market each quarter in its Form 10-Q and Form 10-K or Form 6-K and Form 20-F for a foreign private issuer. It sometimes files a prospectus supplement with the same disclosure, perhaps to be extra cautious and to abide by Rule 430B(h), under the Securities Act, which requires an issuer to file a prospectus supplement when material information about the securities offered is incorporated by reference from its Exchange Act reports.

securities exchange or facility thereof, a trading facility of a national securities association, or an alternative trading system.[12]

[D] Ongoing Due Diligence

Ongoing due diligence is one of the most significant differences between an ATM program and a traditional follow-on offering. For an ATM program to be most effective, the agents must be ready for the issuer to do a takedown at any time, subject to customary restrictions during trading blackout periods. The issuer therefore allows the agents to do periodic supplemental due diligence. ATM programs generally specify that the issuer will: (i) repeat its representations and warranties with each takedown; (ii) provide bring-down comfort letters, legal opinions, and negative assurance letters each quarter; (iii) provide other supporting documents, such as officers' certificates and other relevant materials, at least quarterly; (iv) make management available for due diligence sessions at least quarterly; and (v) provide these documents or make management available from time to time, at the agents' request.[13]

[E] Announcement and Execution of Sales

Unlike traditional underwritten public offerings, takedowns do not usually include marketing activities such as road shows or investor meetings. Issuers may also avoid these activities to prevent the takedown from classification as a "distribution" under Regulation M, as discussed below. But the issuer will usually publish a press release to announce the establishment of an ATM program and inform the market of its plan to raise capital—which could be material information.

In contrast, relative to the issuer's public float or the daily trading volume of the securities in question, the number of securities sold in any particular takedown is usually insignificant. In accordance with parameters set by the issuer, the agents execute sales through ordinary transactions on securities exchanges or through alternative trading facilities at then-prevailing market prices.[14] At the end of the day, the agents report to the issuer the number of shares sold, gross proceeds, and related commissions. As in a traditional underwritten public offering, settlement is usually on a T+2 basis.[15]

§ 1:2.4 Legal and Regulatory Considerations

[A] Regulation M

Regulation M under the Exchange Act addresses potentially manipulative practices by participants in securities offerings. Rules 101 and 102 of Regulation M prohibit issuers, distribution participants, and their affiliated purchasers from directly bidding for, purchasing, or attempting to induce another person to bid for or purchase a "covered security"[16] during the applicable restricted period for a distribution.[17] If ATM

[12] For an ATM program, the main conditions to be satisfied are that: (i) securities of the same class as the securities that are the subject of the transaction are trading on the exchange, facility, or system; (ii) the registration statement relating to the offering is effective and is not the subject of any stop order or related proceeding; and (iii) the issuer has filed or will file a prospectus that satisfies Section 10(a) of the Securities Act. *See* Securities Act Rule 153(b).

[13] Issuers are often asked to provide officer's certificates and participate in update due diligence calls more frequently. The parties may agree to these steps orally at the outset of an ATM program instead of including them in the equity distribution agreement. Agents also may seek supplemental due diligence in connection with developments that affect the issuer or its sector.

[14] The elimination of the requirement to carry out ATM offerings on or through a national securities exchange or market maker is significant given the rise of so-called "dark pools," which now capture a substantial portion of trading volume in many securities listed on the New York Stock Exchange (NYSE) and NASDAQ Stock Market (NASDAQ).

[15] *See* Exchange Act Rule 15c6-1(a).

[16] Regulation M defines a "covered security" as "any security that is the subject of a distribution, or any reference security." Regulation M Rule 100. A "reference security" is "a security into which a security that is the subject of a distribution ('subject security') may be converted, exchanged, or exercised or which, under the terms of the subject security, may in whole or in significant part determine the value of the subject security." *Id.*

[17] In an ATM offering, the restricted period begins one or five business days before the pricing of each sale and continues until each agent's participation in the distribution

takedowns were "distributions" under Regulation M, then without an exception, the agents would be unable to trade the securities during the term of the program because of the potential for a takedown each day.[18] Market making and other ordinary broker-dealer trading would be difficult to execute.

Regulation M defines a "distribution" as an offering "distinguished from ordinary trading transactions by the magnitude of the offering, and the presence of special selling efforts and selling methods."[19] According to the SEC, ordinary trading transactions in an independent market without special selling efforts are not considered "distributions," but "unusual transaction-based" compensation for agents may change that characterization.[20] For this reason, agents usually do not participate in ATM programs unless the securities fall within the "actively-traded securities" exception from Regulation M. Under that exception, the restrictions of Regulation M do not apply to the agents[21] if the securities have worldwide "average daily trading volume" of at least $1 million and the issuer has a "public float value" of at least $150 million.[22]

[B] Publication and Dissemination of Research Reports

If an agent or its affiliate already publishes research coverage about the issuer, it should be able to continue to do so during an ATM program. The agent may rely on the safe harbor in Rule 139 under the Securities Act. Rule 139 provides that if certain conditions are met, research reports about an issuer or its securities will not be deemed "offers" under the Securities Act's registration provisions. To qualify, the agent must publish the research reports in its regular course of business. The agent may not begin coverage or re-initiate coverage if it had been discontinued. The issuer must be eligible to use Form S-3 or Form F-3—which should be the case for an ATM issuer—and meet certain other criteria.[23]

FINRA Rule 2241(b) of the Financial Industry Regulatory Authority (FINRA) may also restrict research activities of the agent or its affiliates during

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is complete. Anti-manipulation Rules Concerning Securities Offerings, Securities Act Release No. 33-7375; Exchange Act Release No. 34-38067 (Dec. 20, 1996).

[18] An issuer will also be restricted under Rule 102 of Regulation M, but typically will not trade its own securities daily.

[19] Regulation M Rule 100(b).

[20] Anti-manipulation Rules Concerning Securities Offerings, Securities Act Release No. 33-7375; Exchange Act Release No. 34-38067 (Dec. 20, 1996) ("A broker-dealer likely would be subject to Rule 101, however, if it enters into a sales agency agreement that provides for unusual transaction-based compensation for the sales, even if the securities are sold in ordinary trading transactions.").

[21] *See* Regulation M Rule 101(c)(1). Rule 102, which applies to issuers, limits an issuer's ability to conduct transactions related to the securities in an ATM program. The issuer can still transact in its other securities—*e.g.*, repurchasing convertible debt securities in the market. Rule 100 of Regulation M defines "ADTV" (*i.e.*, average daily trading volume) as "worldwide average daily trading volume during the two full calendar months immediately preceding, or any 60 consecutive calendar days ending within the 10 calendar days preceding, the filing of the registration statement; or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to [Rule 415 under the Securities Act], two full calendar months immediately preceding, or any consecutive 60 calendar days ending within the 10 calendar days preceding, the determination of the offering price."
With respect to "public float value," Rule 100 of Regulation M indicates that it "shall be determined in the manner set forth on the front page of Form 10-K . . . even if the issuer of such securities is not required to file Form 10-K, relating to the aggregate market value of common equity securities held by non-affiliates of the issuer."

[22] Rule 104 of Regulation M prohibits both the issuer and the agents from engaging in stabilization activities with respect to the securities sold in an ATM offering. Under Rule 103 of Regulation M, agents are prohibited from passive market-making on NASDAQ during an ATM offering.
Purchasers of securities in an ATM offering (other than a firm commitment takedown, which is rare) will be exempt from Rule 105 of Regulation M, which prohibits purchasers from covering certain short sales with securities purchased in an SEC-registered firm commitment offering for cash. Regulation M Rule 105(c).

[23] Rule 139 would not be available to a non-investment grade issuer that does not have a $75 million public float. *See* Securities Act Rule 139(a)(1).

an ATM program. If a FINRA member acts as manager or co-manager of a follow-on offering, FINRA prohibits those members from publishing research reports on the issuer for three calendar days after the offering date. For an issuer with "actively-traded securities" as defined in Regulation M, however, this restriction does not apply to research that complies with Rule 139.[24] As discussed above, ATM programs usually satisfy this requirement.[25] Finally, investment banks may impose additional restrictions on research under their own internal policies.

[C] Other Compliance Requirements

In addition to compliance with the federal securities laws, issuers and agents in an ATM program must comply with the requirements of other regulatory bodies. With respect to the applicable shelf registration statement, FINRA may impose requirements for filings and approval or exemption therefrom.[26] The applicable securities exchange may also impose listing requirements. Because equity securities sold under ATM programs are listed on national U.S. securities exchanges, federal securities laws generally pre-empt state "blue sky" laws.[27]

§ 1:3 Block Trades

§ 1:3.1 Overview

A block trade is a placement of a large block of equity securities by an issuer or selling securityholder.[28] Unlike in traditional underwritten registered offerings, in a block trade, the underwriter commits to purchase the block at an agreed price before it builds a book of orders. Block trades are sometimes called "bought deals" for that reason. There are two types of block trades: SEC-registered block trades and exempt block trades. Registered block trades require the issuer to have an effective shelf registration statement on file, while exempt block trades require the issuer to use a specific exemption from registration for the trade.

Block trades benefit issuers or selling securityholders because they mitigate execution risk. The net proceeds are guaranteed before the offering is launched. This certainty does come at a cost, however—in a block trade, the issuer or selling securityholder usually must accept a bigger discount to the prevailing market price of the securities. The underwriter will also want to eliminate risk by reselling the securities to investors as soon as possible, which can put pressure on the parties to prepare in advance and move quickly.[29]

§ 1:3.2 Structure of SEC-Registered Block Trades

Like an ATM offering, an SEC-registered block trade is a takedown from an issuer's effective shelf registration statement. Unlike an ATM offering, block trades require underwriters. The issuer informs potential underwriters of the contemplated trade and invites them to bid for the block. The bidding underwriters also receive a short amount of time for

[24] Rule 101 of Regulation M also excepts from its restrictions research reports published pursuant to Rule 138 or Rule 139. If the subject securities are "actively-traded securities" within the meaning of Regulation M, the restrictions of Rule 101 would not apply to the agents.

[25] "Emerging growth companies," or "EGCs," are also not subject to the research report restrictions of FINRA Rule 2241(b)(2)(I)(ii). *See* FINRA Rule 2241(b)(2)(I).

[26] FINRA Rule 5110 imposes a filing and approval requirement for a shelf registration statement on Form S-3 or Form F-3 where the issuer does not qualify as an "experienced issuer"—*i.e.,* have a 36-month reporting history, and at least $150 million market value of voting stock held by non-affiliates ($100 million if the issuer has an annual trading volume of at least three million shares).

[27] *See* Securities Act § 18.

[28] The term "block trade" is used colloquially to refer to an accelerated offering of securities, even if the underwriters conduct a traditional bookbuilding exercise before they commit to purchase the securities. This discussion addresses the concerns raised by the traditional concept of a block trade or "bought deal." It focuses on a primary offering by an issuer, rather than a secondary offering by a selling securityholder. The considerations are similar in both. The selling securityholder can often require the issuer to facilitate a sale on its behalf, under registration rights the selling securityholder acquired when it invested in the securities.

[29] In March 2008, the Securities Industry and Financial Markets Association published "Block Trade Guidelines" that outline the steps of the offering process in an SEC-registered block trade. The guidelines emphasize that execution in block trades is much quicker than in a typical underwritten offering and that speed is critical to success.

due diligence. In most cases, the winning underwriter is chosen and the price agreed immediately after the close of trading at 4:00 p.m. Eastern Time (ET). The underwriter then begins reselling the securities to investors and ideally finishes the resales by the time trading reopens at 9:30 a.m. ET the next day.

An issuer's contemplation of a block trade may itself be material non-public information. The determination will depend on factors such as the size of the block relative to the issuer's public float, the securities' average daily trading volume, and the identity of the offeror (either the issuer or a selling securityholder). To prevent potential investors from trading on the basis of material non-public information and to avoid violations of Regulation FD's prohibition on selective disclosure, the issuer will announce the block trade publicly before the underwriter approaches potential investors, though limited pre-marketing is sometimes possible.[30] In a secondary block trade, a selling securityholder will generally do the same.[31]

[A] Shelf Registration Statement

To do a block trade, the issuer must have an effective shelf registration statement, typically on Form S-3 or Form F-3, with enough securities available for the block. If the issuer is a well-known seasoned issuer (a "WKSI"),[32] it will have more flexibility. WKSIs can file registration statements on Form S-3 or Form F-3 that become effective immediately if they do not already have one on file.[33]

[B] Due Diligence

Registered block trades are subject to the same disclosure requirements and liability concerns as traditional underwritten registered offerings of equity securities. In spite of the time pressure, the issuer and underwriter must therefore ensure all disclosures are accurate and complete before they price the offering. The issuer may include additional information for investors in a press release on a Form 8-K or 6-K, as well as in the preliminary prospectus supplement used to market the offering.[34]

Because time is so limited, due diligence sessions for block trades are usually a group phone call with management, the auditors, and the prospective underwriters as they prepare their bids.[35] The issuer will engage designated underwriter's counsel before it puts out the bid. The underwriter's counsel will have

[30] The SEC adopted Regulation FD in 2000. It prohibits U.S. issuers from selectively disclosing material non-public information to market professionals and to securityholders when it is reasonably foreseeable that the holders will trade on the basis of the information. Whenever an issuer intentionally discloses material non-public information, it must do so through a general public disclosure, and whenever an issuer learns that it has made a non-intentional selective disclosure, it must make public disclosure of that information promptly. Regulation FD does not apply to foreign private issuers, but foreign private issuers nonetheless avoid selective disclosure of material non-public information due to concern for potential liability under Rule 10b-5 and as a matter of best practice.

[31] *See also* FINRA Rule 5270 (addressing front-running of block trades).

[32] The Securities Offering Reform introduced the WKSI concept. Among other benefits, a WKSI's shelf registration statements become effective automatically, facilitating quicker access to the public capital markets. Rule 405 under the Securities Act defines a "WKSI." A WKSI is a company that (i) on the determination date, meets the registrant requirements of Form S-3 or F-3, including having timely filed its Exchange Act reports for the preceding 12 calendar months; and (ii) within 60 days of that determination date either (1) has a worldwide market value of at least $700 million of its voting and non-voting common equity held by non-affiliates, or (2) (x) in the preceding three years, has issued at least $1 billion aggregate principal amount of registered non-convertible securities, other than common equity, in primary offerings for cash and (y) registers only non-convertible securities, other than common equity (unless the issuer also meets the $75 million public float requirement of Form S-3 or F-3, in which case registration of common equity is permitted). *See* Securities Offering Reform, Securities Act Release No. 33-8591; Exchange Act Release No. 34-52056 (July 19, 2005).

[33] A WKSI can also take advantage of the "pay-as-you-go" provisions of Rules 456(b) and 457 under the Securities Act to delay payment of its registration fees, which can help facilitate speedy execution.

[34] If there are no material developments to convey to investors, it may be possible to market the offering using just the disclosure in the base prospectus and any existing updates thereto (*e.g.*, through periodic and current reports incorporated by reference therein).

[35] To protect the integrity of the bid process, special measures may be implemented to prevent the potential

done due diligence and helped structure the offering, so it can advise bidders on these points during the short bidding period. The underwriter's counsel will also be ready to deliver a 10b-5 letter to the winning bidder. The issuer's auditor will be ready to do the same with comfort letters.

[C] Selling Securityholders and Disclosure

For a block trade by an affiliate selling securityholder, the underwriter usually requires a "clean hands" representation that the selling securityholder neither possesses material non-public information nor has decided to sell the securities based on material non-public information. If the affiliate selling securityholder does have material non-public information, the issuer could disclose it before the offering. If the issuer is not yet obligated to disclose the information and wants to avoid doing so publicly before that time, though, this approach may not work.[36] The affiliate may need to delay its sale of the securities in that case.[37] For these reasons of risk and disclosure, both issuers and selling securityholders often time block trades to follow the issuer's earnings release or the filing of a periodic report.

[D] Fixed Versus Variable Price Reoffer

With so little time to resell the securities after launch, the underwriter may prefer to offer the securities to investors at prices that are variable instead of fixed. If the block trade is structured on a variable price reoffer basis, the offering documents will disclose that the underwriter will reoffer the securities from time to time at market prices or at variable negotiated prices.[38]

[E] Limited Premarketing

In most bid processes for registered block trades, prospective underwriters do not contact potential investors before they submit bids. In some cases, prospective underwriters do limited pre-marketing before they submit a bid and before the offering's launch is announced publicly. Between the time the block trade is put out to bid and the time that bids are due, prospective underwriters may try to reach investors to gauge demand. The issuer will want to limit these activities to prevent leaks and to avoid pressure on its stock price before it has agreed to sell securities. Nevertheless, pre-marketing may be permitted as long as it does not offend the registration requirements of the Securities Act or concerns about insider trading and Regulation FD.

In a registered block trade, a registration statement that covers the offered securities must be on file with the SEC before an oral offer to sell can be made. The shelf registration statement on file should satisfy this

bidders from identifying each other—*e.g.*, questions for management may be passed offline through a representative of the issuer.

[36] In contrast to the securities laws of many other jurisdictions, the U.S. federal securities laws do not impose a continuous obligation to disclose material information. Absent the obligation to file a periodic or current report under the Exchange Act (*e.g.*, a Form 10-Q, Form 10-K, Form 8-K, Form 20-F or Form 6-K) or (for a domestic issuer) a proxy statement in connection with a shareholder meeting, the timing of disclosure of material information is generally up to the issuer.
NYSE and NASDAQ rules do require prompt disclosure of material information. *See* New York Stock Exchange, Listed Company Manual §§ 202.01, 202.05; NASDAQ Stock Market Rules, Rule 5250(b)(1). They do not have the force of law, however, and do not give rise to a private right of action. *See* State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 852 (2nd Cir. 1981).
As always, if a person chooses to offer or sell securities, failure to disclose material non-public information can result in criminal and civil liability under the securities laws.

[37] It is common for the registration rights agreement, under which the selling securityholder has the right to use the shelf registration statement for the block trade, to allow the issuer to impose this sort of delay.

[38] It is customary to issue a pricing press release in most types of deals, including traditional firm underwritten offerings. In a variable price block trade, a pricing press release would be unusual because there is no single price to the public. In a fixed-price block trade, a pricing press release often is issued and, in some cases, for a NYSE-listed issuer, the NYSE may insist on a press release if it considers the underwriting discount or the price to the public material. This issue should be discussed with counsel and, when appropriate, the NYSE.
In some cases, the underwriting discount will reflect not only a discount to the market at the time of launch, but also the price at which the securities are sold to the public.

requirement.[39] The issuer's plan to do the block trade is itself likely to be material non-public information. If so, or if any other material non-public information will be shared, any discussions with potential investors must follow "wall-crossing" procedures. Potential investors must agree to keep the information confidential until the offering is announced publicly or until a specified date after which the issuer will have abandoned the offer. By that time, any material non-public information shared with the investors will either have been disclosed or no longer be material.[40]

§ 1:3.3 Structure of Exempt Block Trades

An issuer may also do an unregistered block trade using one of three exemptions from registration under the Securities Act: Rule 144, Rule 144A, and Regulation S. An unregistered block trade can take less time and money than a registered block trade. Although exempt block trades are subject to Section 10(b) and Rule 10b-5 under the Exchange Act,[41] they are not subject to the higher standards of liability that attach to registered offerings under Sections 11 and 12(a)(2) of the Securities Act because they are unregistered.[42] Since there is no offering document, the purchase agreement typically contains only limited representations and warranties (*e.g.,* relating to ownership of securities and non-possession of material non-public information) and covenants (*e.g.,* relating to furnishing of information and filing of Form 144, if applicable).

Though certain liability provisions of the securities laws do not apply without a registration statement, the lack of an offering document increases exposure to

[39] Although Rule 163 under the Securities Act permits a WKSI to make unrestricted oral and written offers relating to its own securities before a related registration statement is filed, this exemption does not extend to underwriters. However, Rule 163B, adopted in 2019, permits any issuer, or any person authorized to act on its behalf (including an underwriter), to engage in oral or written communications with certain types of potential investors to determine whether they might have an interest in a contemplated registered securities offering. The potential investors are limited to those that are, or are reasonably believed to be, "qualified institutional buyers" (QIBs), as defined in Rule 144A under the Securities Act, or "institutional accredited investors" (IAIs), within the meaning of Rule 501(a)(1), (a)(2), (a)(3), (a)(7), or (a)(8) under the Securities Act. (Following the effectiveness of the AI Amendments on December 8, 2020, Rule 163B will be updated to refer to IAIs within the meaning of Rule 501(a)(1), (a)(2), (a)(3), (a)(7), (a)(8), (a)(9), (a)(12), or (a)(13).) These "testing-the-waters" or "TTW" communications can take place before or after a registration statement is filed.

[40] *See* Rule 100(b)(2)(ii) of Regulation FD, which excludes from the prohibition on selective disclosure information shared with a person "who expressly agrees to maintain the disclosed information in confidence." *See infra* note 85.

[41] The Supreme Court has substantially limited the extraterritorial applicability of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in private rights of action. *See* Morrison v. Nat'l Austl. Bank, 130 S. Ct. 2869 (2010). In *Morrison*, the Court held that Section 10(b) did not provide a cause of action for foreign plaintiffs who purchased securities on a foreign exchange because the securities were listed only on a foreign exchange and "all aspects of the purchases . . . occurred outside the United States." *Id.* at 2888. The Court established a new "transactional" rule that Section 10(b) reaches only "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 2884. Investment banks nonetheless proceed cautiously in the context of Regulation S–only undocumented transactions. Their concerns are reputational risk and potential liability under non-U.S. securities laws. In addition, the *Morrison* standard does not apply to enforcement actions brought by the SEC. These are subject to the lower "conducts and effects" test—*i.e.*, if the wrongful conduct occurred in the United States or had a substantial effect in the United States. *See also* United States v. Scoville, 913 F.3d 1204 (10th Cir. 2019).

[42] Section 11 of the Securities Act imposes liability on the issuer, underwriters, and specified other persons if, at the time it becomes effective, any part of the registration statement (including the prospectus) includes "an untrue statement of a material fact or omit[s] to state a material fact necessary in order to make the statements therein not misleading." Section 12(a)(2) of the Securities Act provides that any person who offers or sells a security "by means of a prospectus or oral communication" that contains a material misstatement of a material fact, or that fails to state a material fact necessary to make the statements therein not misleading, is liable to the purchaser for damages. By contrast, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder require a showing of *scienter*—*i.e.*, a knowing violation or at least recklessness. This standard is more difficult for a plaintiff to meet than the standards under Sections 11 or 12(a)(2).

liability under Section 10(b) and Rule 10b-5, as well as under non-U.S. securities laws.[43] For that reason, U.S. investment banks facilitate undocumented offerings under Rule 144A or Regulation S only after careful consideration.[44] The bank will consider the size of the issuer, its reporting history, the relevant markets and liquidity of trading, the quality of the issuer's reporting and research coverage, the amount of time since the issuer's most recent periodic report, and recent developments relating to the issuer, its industry, and its home country.[45] The placement may also be limited to very sophisticated institutional investors. Each investor will sign a letter acknowledging that it has not relied on the seller to make its investment decision and representing that it is sophisticated and able to bear the loss of the investment.[46]

[A] Exempt Block Trades Under Rule 144

Rule 144 provides a non-exclusive safe harbor for selling securityholders to resell restricted securities and control securities freely in the United States.[47]

— "*Restricted securities*" are securities acquired directly or indirectly from an issuer, or from an affiliate of an issuer, "in a transaction or chain of transactions not involving any public offering."

— "*Control securities*" are securities held by an affiliate of an issuer, whether restricted, acquired in the open market, or acquired in a registered offering.

— An "*affiliate*" of an issuer "is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with," the issuer.[48]

A holder of restricted or control securities cannot publicly offer or sell the securities in the United States unless the offer or sale is registered under the Securities Act or an exemption from registration is available. Reliance on Rule 144 avoids the need to use a resale registration statement, but, as in a registered resale, the purchaser will receive unrestricted securities.

[43] Undocumented offerings of this type, including by affiliates of the issuer, are more common in Europe and Asia than in the United States. Unlike in the United States, affiliate sales in these regions do not trigger registration requirements and can be done similarly to ordinary course secondary market sales.

[44] These concerns are generally not present in a block trade under Rule 144, in which sales are made on behalf of a non-affiliate or without special selling efforts.

[45] If a selling securityholder is involved, the investment bank also will consider whether it is an affiliate of the issuer, whether the seller has access to material non-public information (*e.g.*, through a board representative), and other factors.

[46] This discussion focuses mainly on offerings of common stock. Block trades in other types of securities, such as convertible and straight debt, are also possible. Because debt securities trade predominantly among institutional investors, an exemption from registration may be available, and the market in a particular bond could be deep enough to make a bought deal structure attractive.

[47] Rule 144 is not available to an issuer or its subsidiaries. *See* SEC Staff, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Question 528.01, *available at* www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (last updated Nov. 6, 2017) [hereinafter Securities Act Rules C&DI] ("Rule 144 is not available for sales of an issuer's securities by its subsidiary, since a parent-issuer may not do indirectly through a subsidiary what it may not do directly under Rule 144. For example, a subsidiary, which is not a bank or trust company, that acts as trustee for its parent's employee benefit plan, would not be permitted to rely on Rule 144 for sales of its parent's securities in connection therewith. [Jan. 26, 2009]" (citing Securities Act Release No. 33-5306 (Sept. 26, 1972)).

[48] Securities Act Rule 144(a)(1), (3). The SEC does not provide specific guidance on the definition of "control" in connection with this definition of "affiliate." Rule 405 under the Securities Act, however, defines "control" as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." The SEC views the *power* to exercise control, and not the *actual* exercise of control, as the central consideration in determining whether control exists. Because the SEC has not articulated concrete indications of control, resolution of this question depends on the facts in each case. Indicia of control may include ownership of more than 10% of an issuer's outstanding voting securities, executive officer status, board representation, or special voting rights (*e.g.*, a veto over significant corporate actions).

Rule 144 has five basic conditions. The holding period condition is most important because in certain circumstances, *restricted* securities held for a sufficiently long period may be sold without the need for adherence to the other four requirements. In contrast, sales of *control* securities—whether or not they are also restricted securities—must always comply with all five requirements of Rule 144 set forth below.

— (1) *Holding Period.* Restricted securities that are not control securities may be freely resold after they have been held[49] for at least six months after acquisition from the issuer or an affiliate of the issuer if (i) the issuer is an Exchange Act-reporter and has been for a period of at least ninety days immediately preceding the sale, and satisfies the requirements set forth below under "Current Public Information" for Exchange Act–reporting companies (or, if the issuer is not current in its Exchange Act reporting or is not an Exchange Act–reporting company, the securities have been held for at least one year), and (ii) the seller is not (and has not been) an affiliate of the issuer within the three months before the date of sale.

— (2) *Amount of Securities Sold.* The amount of securities sold during any three-month period must not exceed the greater of (i) 1% of the outstanding securities of the class being sold, and (ii) if the class of securities is listed on a national securities exchange, the average weekly reported volume of trading in the issuer's securities on all national securities exchanges (and otherwise reported to the consolidated tape) during the four weeks prior to the filing of notice on Form 144 described below (or, if no such notice is required, the date of receipt by the broker of an order to execute the sale of securities or the date of execution directly with a market maker of the sale). For securities traded over-the-counter, only the 1% measurement may be used.[50]

— (3) *Manner of Sale.* The securities (other than debt securities, non-participatory preferred stock and asset-backed securities) must be sold through a broker, in direct transactions with a market maker, or in riskless principal transactions. In addition, among other limitations, it is prohibited to solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with the sale. The sale must be handled as a routine trading transaction, and if done through a broker, the broker may not receive more than a normal commission.[51]

— (4) *Current Public Information.* The issuer must satisfy certain public information requirements. The issuer must (i) be, and have been for a period of at least ninety days immediately before the sale, an Exchange Act–reporting company and (ii) have filed all required Exchange Act reports[52] during the twelve months preceding the sale (or for such shorter period that the issuer was required to file such reports). Even if the issuer is not an Exchange Act–reporting company, this requirement may still be satisfied if certain

[49] When determining the length of the holding period, a holder may be permitted to include, or "tack," periods in which prior non-affiliate holders held the restricted security, so the aggregate holding period meets the requirements of Rule 144. If the issuer or an affiliate acquires and privately resells the securities, however, a new holding period will begin.

[50] An alternative volume test is available for debt securities, non-participatory preferred stock, and asset-backed securities. Specifically, in addition to the 1% and average weekly trading volume tests, during the three-month period, an affiliate holder can sell up to 10% of the tranche or class being sold. *See* Securities Act Rule 144(e)(2).

[51] Although solicitation is generally prohibited, a market maker may solicit purchases once it has purchased the securities.

[52] For purposes of this requirement, reports on Form 8-K (*i.e.*, periodic reports filed by U.S. issuers to report certain specified events) are disregarded, as are reports on Form 6-K (the analogous report for foreign private issuers). Accordingly, only the filing of Forms 10-K and 10-Q for domestic issuers and Form 20-F for foreign private issuers is relevant to determine if this requirement has been satisfied.

equivalent information is made publicly available.[53]

— (5) *Notice of Proposed Sale.* The seller must file a Form 144 with the SEC if the total amount of securities to be sold under Rule 144 during any three-month period exceeds 5,000 shares or has an aggregate sale price greater than $50,000. If the securities are traded on an exchange, the seller must file a copy of the Form 144 with the principal securities exchange on which the securities trade. The form must be filed at the same time as the placement of an order to execute the sale of the securities with the broker or as the direct execution of the sale with a market maker.

[B] Exempt Block Trades Under Rule 144A

Rule 144A provides a non-exclusive safe harbor from registration for a seller to resell to institutions it reasonably believes to be "qualified institutional buyers" (QIBs) of securities that are not "of the same class," or fungible, with securities listed on a national securities exchange such as the NYSE or NASDAQ.[54] In general, to be a QIB, an institution must invest on a discretionary basis at least $100 million of securities of issuers not affiliated with the institution. The market among QIBs must also be deep enough to support the contemplated block trade.[55] (Absent such a market, a resale may still be structured using Rule 144A, but likely not as a bought deal.)

Because of the fungibility requirement, Rule 144A generally does not work for exchange-listed securities. There is, however, an important exception to the fungibility requirement for securities of a class that are issued before that class is listed—often referred to as "founders' shares." This exception would allow a selling securityholder to use Rule 144A to sell shares of common stock that it acquired before the issuer listed that stock in the United States.[56] Again, there would need to be a sufficiently deep and liquid private market to support the trade.

Rule 144A imposes only two procedural requirements. First, the seller must take reasonable steps to ensure that purchasers are aware of its reliance on the rule. Second, for issuers (other than foreign governmental issuers) that do not report or furnish information to the SEC under the Exchange Act, purchasers must have a right to obtain certain information about the issuer before the sale.[57] Purchasers in 144A transactions receive restricted securities that can be resold only upon registration or pursuant to an exemption from registration.

[C] Exempt Block Trades Under Regulation S

Regulation S is a complex exemption from registration that covers offers and sales of securities outside the

[53] Rule 144(c)(2) requires that certain information about a non-reporting issuer specified in Rule 15c2-11 under the Exchange Act be publicly available. *See* Exchange Act Rule 15c2-11(a)(5)(i)–(xiv), (xvi).

[54] Pink Sheets and OTC Bulletin Board bid and ask quotations for a security do not render Rule 144A unavailable.

[55] Historically, there has not been a significant secondary market for common stock trading under Rule 144A. As companies remain private longer, however, pre-IPO holders increasingly are seeking avenues for liquidity.

[56] If Rule 144A is unavailable (*e.g.*, because the founders' stock exception is unavailable), the securities still may be resold on a private basis to a QIB or to an accredited investor (AI) (a term that generally includes most institutions and certain wealthy individuals). *See infra* note 68. Because traditional resales fall outside the safe harbor provided by Rule 144A, to ensure that the securities are not resold to a person other than a QIB or AI, it generally is necessary to require (i) an opinion from counsel that the resale is exempt from registration, (ii) an investor representation letter from the purchaser addressing its status as a QIB or AI and certain other points relating to its purchase of the securities and (iii) certificated legended securities or similar means of restricting transfer (*e.g.*, immobilization in a restricted account). The investor representation letter also generally requires any subsequent sales by the purchaser to satisfy the same requirements. These requirements are essentially incompatible with the sort of market that would support block trades.

[57] This information includes a brief description of the issuer's business, and the products and services it offers, as well as certain balance sheet, profit and loss and retained earnings statements, and similar financial statements for that portion of the two preceding fiscal years during which the issuer has been in operation.

United States. The regulation contains two safe harbors. The first covers offers and sales by issuers and their affiliates, as well as by distribution participants such as underwriters.[58] The second covers resales by others such as non-affiliate holders of restricted securities.[59] U.S. issuers rarely use Regulation S for resales of equity securities because it is so cumbersome.[60] For foreign private issuers, though, Regulation S can be a useful option.[61] Although issuers cannot use Regulation S to reach the U.S. investor base, a Regulation S offering can be done alongside a registered offering or an offering pursuant to another exemption from registration.[62]

§ 1:3.4 Other Considerations for Registered and Exempt Block Trades

[A] Sections 13 and 16 of the Exchange Act

Selling securityholders in a block trade should be mindful of potential reporting obligations under Sections 13 and 16 of the Exchange Act and liability for short-swing profits under Section 16. A person must file a Schedule 13D or Schedule 13G if the person "beneficially owns" more than 5% of a class of Exchange Act-registered voting equity and must amend those filings if there are material changes to that beneficial ownership. Section 16 has various requirements for "insiders" of a domestic issuer[63] with Exchange Act-registered equity. First, the insiders must report their transactions in the issuer's equity securities. Second, absent an applicable exemption, insiders must disgorge to the issuer any profits or deemed profits from "short-swing" trading in the

[58] The first safe harbor applies to issuers and their affiliates, as well as underwriters and others that participate in the distribution of the securities pursuant to a contractual arrangement. Two conditions must be satisfied for an offer or sale to qualify: (i) the offer and sale must be an "offshore transaction" (as defined in Regulation S) and (ii) there may be no "directed selling efforts" (as defined in Regulation S). Securities Act Rule 903(a). In addition to the offshore transaction requirement and prohibition on directed selling efforts, further requirements may have to be met to qualify for the first safe harbor. The applicable requirements depend on the extent to which there is a nexus with the United States, with more stringent requirements applying the greater the SEC views a need for protection of U.S. investors. The spectrum ranges from Category 1, where the likelihood of the securities flowing back into the United States is most minimal, to Category 3, where that likelihood is greatest. *See* Securities Act Rule 903(b).

[59] The second safe harbor covers offshore resales by persons other than the issuer or an affiliate of the issuer, or a distributor or any of its affiliates, of securities initially placed offshore or by private placement in the United States. These persons generally can resell their securities outside the United States immediately, provided the "offshore transaction" requirement is satisfied and directed selling efforts are not used in the United States. *See* Securities Act Rule 904.

Notwithstanding the availability of this safe harbor, in practice, most resales of securities are covered by another exemption from registration, such as Section 4(a)(1) of the Securities Act, which provides an exemption for transactions by any person other than an issuer, underwriter or dealer. The safe harbor of Rule 904 therefore generally is used only when the securities being offered or sold are restricted and the seller is not an affiliate of the issuer (or is an affiliate only by virtue of being a director or officer of the issuer, who are permitted to use this safe harbor, subject to certain limitations).

[60] In particular, equity securities offered by a U.S. issuer under Regulation S are treated as "restricted securities" and subject to cumbersome transfer mechanics. *See* Securities Act Rules 903 and 905.

[61] Of course, when offering securities offshore, it also is necessary to consider securities law and other requirements that may apply in the relevant jurisdictions. It often is possible to structure offshore offerings in a manner that avoids having to prepare a prospectus or otherwise comply with a process analogous to SEC registration.

[62] *See* Preliminary Note 5 to Regulation S ("Attempted compliance with any rule in Regulation S does not act as an exclusive election; a person making an offer or sale of securities may also claim the availability of any other applicable exemption from the registration requirements of the Act.").

[63] Rule 3a12-3(b) under the Exchange Act exempts securities registered by a foreign private issuer from U.S. proxy rules under Section 14 of the Exchange Act and short-swing profit reporting and disgorgement rules under Section 16 of the Exchange Act.

issuer's equity securities: matchable purchases and sales of those securities within six months of each other.[64] "Insiders" include officers, directors, and shareholders beneficially owning more than 10% of a class of registered voting equity.

[B] FINRA

Given the speed of block trades, participants must clear all regulatory hurdles in advance. FINRA's Corporate Financing Rule, Rule 5110, is especially important. The rule imposes limits on broker-dealer compensation, prohibits unfair and unreasonable underwriting practices, and, most importantly, imposes filing and approval requirements in certain circumstances before a transaction can be launched. The rule exempts filings by issuers of investment-grade non-convertible debt, as well as "experienced issuers."[65] Accordingly, even a WKSI that can file an immediately effective shelf registration statement may not meet the standard if it is a relatively new issuer. FINRA has procedures, however, that allow for a shelf registration statement to be cleared quickly.[66]

[C] Shareholder Approval

In an offering of common stock, both the NYSE and NASDAQ generally require shareholder approval for any issuance of common stock greater than or equal to 20%—in terms of number or voting power—of the shares of common stock outstanding before the issuance. A public offering for cash, however, generally should be exempt from this requirement.[67]

[D] Other **Compliance Requirements**

For securities listed on a U.S. national securities exchange, state blue sky laws should be preempted under Section 18 of the Securities Act. For offerings under Rule 144A, an exemption from the blue sky laws of each state should apply, and Regulation S offerings are not subject to blue sky laws because they are done offshore.

Rules 101 and 102 under Regulation M except transactions in Rule 144A-eligible securities sold to persons reasonably believed to be QIBs or to persons not deemed to be "U.S. persons" for purposes of Regulation S during the course of a Rule 144A offering.

§ 1:4 Private Investment in Public Equity (PIPE)

§ 1:4.1 Overview

In a private investment in public equity (PIPE) transaction, a public company makes a private placement of securities to a single or limited group of accredited investors.[68] After the PIPE, the securities are usually registered for resale with the SEC. A PIPE can minimize execution risk and offer quick financing to issuers while providing discounted pricing and

[64] In general, the term "equity security" is defined very broadly for purposes of Section 16. In addition to common stock, the term "equity security" includes derivative securities, such as options to acquire stock and debt convertible into stock, as well as other contracts, rights or arrangements the value of which is based on the value of an equity security, including equity swap contracts. A transaction in a non-derivative equity security can be matched with a transaction in an equity derivative security.
[65] See *supra* note 26.
[66] These filing exemptions are not available to the extent an offering involves certain conflicts of interest. *See* FINRA Rules 5110 and 5121.
[67] *See* NYSE Listed Company Manual Section 312.03 and NASDAQ Stock Market Rule 5635(d). Other stock exchange shareholder approval requirements also may be implicated—*e.g.,* when issuing to directors, officers or significant shareholders. The shareholder approval requirements of the NYSE and NASDAQ generally do not apply to a foreign private issuer. *See* NYSE Listed Company Manual, § 103.00; NASDAQ Stock Market Rules, IM-5615-3 (Foreign Private Issuers).
[68] "Accredited investor" (AI) is defined in Rule 501(a) under Regulation D, which sets forth safe harbors under Section 4(a)(2) of the Securities Act from SEC registration for private placements. On August 26, 2020, the SEC adopted amendments to the definition of Accredited Investor in Rule 501(a) (the "AI Amendments"). The AI Amendments will become effective on December 8, 2020. *See* SEC Release No. 33-10824 (Aug. 26, 2020). PIPE transactions are typically limited to AIs for two main reasons. First, although securities may be sold under Rule 506(b) of Regulation D to up to 35 non-AIs, the rule allows for sales to an unlimited number of AIs. Second, Rule 502(b) of Regulation D requires extensive information to be furnished to any investors that are not AIs.

favorable terms to investors. PIPE structures can be used to offer all types of securities, including common stock, convertible and non-convertible preferred stock, convertible debt, warrants, and structured products. Historically, distressed, small, or mid-sized issuers have used PIPEs when other options for financing are not feasible. Because PIPEs are a relatively quick and discreet way to raise capital, larger, well-capitalized issuers may also choose PIPEs when markets are volatile. PIPE activity spiked, for example, at the outset of the COVID-19 crisis.

An issuer might prefer a PIPE over a traditional offering for several reasons. Because PIPEs are not registered offerings, they avoid the potential delays of SEC review. Another advantage is that issuers may disclose the transaction publicly only after investors commit to purchase the securities.[69] This timing minimizes pressure on the issuer's stock price and harm to its reputation if the offering is not completed. PIPEs are normally done on a best efforts basis, rather than by a firm commitment. Transaction expenses are typically lower than those of a traditional underwritten registered offering for that reason.

PIPEs also have disadvantages. After the private placement closes, PIPE investors receive restricted securities. To compensate for the resulting lack of liquidity, investors typically insist on sizeable discounts to the market price of the securities. In addition, because the securities are offered to only a limited set of investors, the parties may negotiate the offering terms extensively. Investors may extract rights beyond those typical of a traditional capital markets transaction, such as preemptive rights, negative covenants, and board seats, especially if the issuer is distressed.

§ 1:4.3 Structure

The issuer may prepare a private placement memorandum or similar disclosure document that describes itself, usually by incorporating its publicly filed Exchange Act reports, and the terms of the offered securities. Though the issuer ultimately sells the securities to the investor directly, an investment bank may act as a placement agent for the structuring and placement of the securities. The private placement is not subject to Sections 11 and 12(a)(2) of the Securities Act, but Section 10(b) of the Exchange Act and Rule 10b-5 thereunder do apply.[70] Accordingly, the placement agent may require legal opinions, 10b-5 letters, and auditor comfort letters to build a defense against potential liability.

The issuer will meet with investors and provide them (most often, the lead investor and its counsel) the opportunity to do due diligence. The offering structure and terms may be heavily negotiated with the lead investor and its counsel and documented in a subscription or purchase agreement, as well as organizational documentation (*e.g.,* a certificate of designation) in the case of a preferred security or debt documentation (*e.g.,* an indenture) in the case of a debt security. In some cases, the filing of the resale registration statement is a condition to closing. In other cases, the parties enter into a registration rights agreement that obligates the issuer to file a resale shelf registration statement within a period of time after closing and use its best efforts to make it effective, or otherwise make specified payments to investors. Consistent with practice under Section 4(a)(2) and Regulation D, settlement normally involves the delivery of physically certificated, legend securities, or

[69] In general, if the transaction is opportunistic and does not proceed, then no disclosure will be needed because the failure of the transaction to proceed will not be material. In circumstances where the transaction's failure is material—*e.g.*, because the issuer desperately needs capital and the failed PIPE shows that it is not likely to be able to obtain it—then disclosure may be warranted. As discussed above in Section 1:3.2[E] and in greater detail in Section 1:4.5 below, if material non-public information regarding the issuer, other than the fact of the transaction itself, is shared with potential investors, then that information should be disclosed or otherwise cease to be material (*e.g.,* due to the passage of time) before the potential investors are allowed to trade in securities of the issuer.

[70] *See supra* note 41 and accompanying text.

securities that are otherwise immobilized from free transfer.[71]

§ 1:4.4 Resale Registration Statement

The SEC will permit a company to register the resale of securities in a PIPE if the investor is at risk when the resale registration statement is filed and irrevocably bound to purchase a fixed number of securities for a fixed price not based on a market price or a fluctuating ratio, either at the time the registration statement goes effective or at any subsequent date.[72] In addition, "[t]here can be no conditions to closing that are within" the investors' control or that the investors "can cause not to be satisfied"—for example, market price-related conditions or satisfactory completion of due diligence.[73]

If the PIPE does not meet these requirements, the SEC may not consider the registration statement a valid secondary offering. Instead, the SEC may consider it an indirect offering by the issuer, in which the investors would have to be identified as "underwriters" in the registration statement (an unappealing prospect given associated liability),[74] and the issuer would have to be eligible to register the securities for sale on a primary basis.[75]

§ 1:4.5 Communications with Potential Investors

To facilitate the due diligence process, prevent potential investors from trading on the basis of material non-public information, and avoid violations by the issuer of Regulation FD, potential investors in a PIPE must enter into a confidentiality agreement. The term of the agreement runs until the launch of the transaction or until a specified date when all material information shared with potential investors will have been disclosed or no longer be material. As in a block trade, the fact that an issuer is contemplating a PIPE is itself likely material non-public information.[76]

§ 1:4.6 Shareholder Approval—Stock Exchanges

Shareholder approval may be necessary to a PIPE transaction if required by the relevant securities exchange. As noted above, both the NYSE and NASDAQ generally require shareholder approval for any issuance of common stock greater than or equal to 20%—in terms of number or voting power—of the shares of common stock outstanding prior to the

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[71] If the offering involves convertible securities or warrants eligible for Rule 144A exemption—*i.e.*, because they are sold only to QIBs and have an effective conversion premium greater than 10% and therefore are not "fungible" with listed securities for purposes of Rule 144A—settlement may occur through DTC using global securities. *See supra* text accompanying note 54.

[72] SEC Staff, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Forms, Question 116.19, *available at* www.sec.gov/divisions/corpfin/guidance/safinterp.htm (last updated Sept. 21, 2020). When the registration statement relates to the resale of shares of common stock underlying unissued, convertible securities, the "analysis applies to the convertible security, not to the underlying common stock." *Id.*

[73] *Id.*

[74] Section 2(a)(11) of the Securities Act defines "underwriter." It is a transaction-based concept that historically has led to difficult interpretive questions. By contrast, the definition of "dealer" in Section 2(a)(12) turns on the basis of the person's typical business. Status as a dealer, however, can affect whether a party will be deemed an underwriter. *See also* the Preliminary Note to Rule 144, which further discusses the interpretive difficulties raised by Section 2(a)(11) and how Rule 144 provides a safe harbor from being deemed an underwriter.

[75] For a discussion of eligibility to use Forms S-3 and F-3 on a primary basis, see *supra* note 7 and accompanying text. It is possible to use Form S-1 for resale registration, but the process can be cumbersome due to inability to incorporate Exchange Act filings by reference and the need to make post-effective amendments to reflect certain fundamental updates. The SEC Staff has stated: "Question: When Form S-1 is used for a continuous offering under Rule 415, is a post-effective amendment necessary to meet the requirements of Section 10(a)(3), to reflect fundamental changes, or to disclose material changes in the plan of distribution? Answer: Yes. A post-effective amendment is required to reflect those changes because Form S-1 does not provide for forward incorporation by reference of Exchange Act reports filed after the effective date. Other changes may be made by prospectus supplement to the extent permitted by Rule 424. [Jan. 26, 2009]." Securities Act Rules C&DI, *supra* note 47, Question 212.11.

[76] *See supra* Section 1:3.2[E].

issuance.[77] They also require shareholder approval if an issuance will result in a change of control of the issuer.[78] In addition, shareholder approval may be required at much lower thresholds when shares are issued to a director, officer, or substantial holder—more likely in a PIPE, in which existing investors may provide substantial support to distressed issuers.[79] Both the NYSE and NASDAQ have a financial viability exception from the shareholder approval requirements.[80] Issuers sometimes avoid using this exception, though, for fear that its invocation may worsen an issuer's financial problems.[81]

§ 1:4.7 Large Holder Considerations

[A] Sections 13 and 16

If an investor acquires more than 5% or 10% of a class of Exchange Act-registered voting equity or a board seat in an Exchange Act-reporting issuer, it should be mindful of reporting obligations under Sections 13 and 16, and obligations to disgorge short-swing profits under Section 16 of the Exchange Act.[82] Under Section 16(c) of the Exchange Act, these investors are also subject to limitations on short sales.

[B] HSR Act

The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), imposes obligations for notification and waiting periods on merger transactions over a certain size (the "Size of Transaction"). The Size of Transaction test is met if the acquiror will acquire and hold certain assets, voting securities, or interests in non-corporate entities valued at more than $376 million. Alternatively, if the Size of Transaction exceeds $94 million, the HSR Act thresholds are met if the parties are greater than a certain size (the "Size of Parties").

The Size of Parties test will be triggered if one party to the transaction has at least $18.8 million in total assets or annual net sales and the other has at least $188 million in total assets or annual net sales. An acquisition made "solely for the purpose of investment"—a phrase defined quite narrowly—is exempt from the HSR Act if the result is that the investor owns no more than 10% of the outstanding voting securities of the issuer.

[C] DGCL Section 203

Section 203 of the Delaware General Corporation Law (DGCL) generally prohibits an "interested stockholder"—a person beneficially owning 15% or more of a corporation's voting stock or an affiliate or associate of that person—from engaging in a "business combination" for three years after becoming an interested stockholder. The prohibition does not apply

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[77] Both NYSE and NASDAQ have exceptions for private placements that otherwise would implicate the 20% rule if the offering price equals or exceeds the most recent closing price or the most recent five-day average closing price. However, because PIPE transactions often involve issuances at a discount to the market price, these exceptions may well be unavailable.

[78] *See* NYSE Listed Company Manual, § 312.03(d); NASDAQ Stock Market Rules, Rule 5635(b).

[79] NYSE Listed Company Manual Section 312.03(b) imposes a shareholder approval requirement in connection with the issuance of common stock (or securities convertible into common stock) to, among others, a director, officer or substantial securityholder of the company "if the number of shares of common stock to be issued, or if the number of shares of common stock into which the securities may be convertible or exercisable, exceeds" 1%—by number or voting power—of the shares of common stock outstanding before the issuance. If the substantial securityholder is not otherwise related to the issuer, and if the issuance relates to a sale of stock for cash at a price at least as great as each of the book and market value of the issuer's common stock, then the 1% threshold is instead 5%.

[80] NYSE Listed Company Manual Section 312.05 provides for a financial distress exception upon application to the exchange where "the delay in securing stockholder approval would seriously jeopardize the financial viability" of the issuer and the audit committee of the issuer has approved expressly reliance by the issuer on the exception. An issuer relying on the exception must mail notice of its use to all shareholders at least 10 days before the relevant issuance. NASDAQ Stock Market Rules, Rule 5635(f) contains a substantially similar exception.

[81] The NYSE also introduced temporary relief from the shareholder approval requirements at the start of the COVID-19 crisis. *See, e.g.,* SEC Release No. 34-90020 (Sept. 28, 2020). The relief, currently extended through year-end 2020, eliminated NYSE requirements that are more stringent than NASDAQ's.

[82] *See supra* Section 1:3.4[A].

if the issuer's board of directors approves the transaction in which the stockholder becomes an interested stockholder or the business combination before the stockholder becomes an interested stockholder. Without this prior board approval, the business combination must be approved by the board and stockholders with at least two-thirds of the outstanding voting stock of the issuer not owned by the interested stockholder. Other jurisdictions have similar prohibitions.[83]

[D] Net Operating Loss Carryforwards

Section 382 of the Internal Revenue Code of 1986, as amended, limits a U.S. corporate taxpayer's use of a net operating loss following an "ownership change." An ownership change generally occurs when the percentage of common stock owned by one or more holders of at least 5% of the common stock increases by more than 50 percentage points from the lowest percentage of common stock that was owned by the 5% stockholders in the preceding three-year period.[84] A large placement to an already significant holder may result in an ownership change.

[E] Regulated Industries

Investments in regulated industries, such as defense / national security, banking, insurance, broadcasting, energy, transportation and gaming, can implicate specialized regulatory regimes that should be considered in each case. A useful initial starting point for identifying regulatory thresholds is the issuer's SEC reporting, which typically describes relevant ownership thresholds and their implications for holders.

§ 1:4.8 Hedging-Related Considerations

Hedge funds and other investors in PIPE transactions may try to hedge their investments by short selling the shares to be acquired in the PIPE or the shares underlying a convertible instrument to be acquired in the PIPE. The SEC has brought several enforcement actions against investors for short sales of common stock when sales occurred before the resale registration statement became effective and were covered with securities purchased in the PIPE once the registration statement became effective.[85] These actions allege that the short sales violated the registration requirements of Section 5 of the Securities Act because they are offers and sales of securities that

[83] *See, e.g.,* Section 912 of the New York Business Corporation Law.

[84] If the limitation applies, the corporate taxpayer can only offset taxable income in taxable years following the ownership change with pre-change net operating losses by an amount generally equal to the product of (i) the applicable federal long-term exempt rate in effect on the date of the ownership change and (ii) the value of the taxpayer's equity immediately prior to the change (or the annual limitation). Any unused annual limitation may be carried forward to increase the amount of income that may be offset by the net operating loss in subsequent years. *See* I.R.C. § 382.

[85] The SEC has also brought insider trading actions against certain investors who sold the equity securities short after learning of the upcoming PIPE but prior to its public announcement. *See, e.g.*, SEC Files Enforcement Action Against Hedge Fund Manager Jeffrey Thorp and Three Hedge Funds for Engaging in Illegal "PIPE" Trading Scheme (SEC v. Langley Partners), SEC Litigation Release No. 19,607 (Mar. 14, 2006); Federal Court Finds Hedge Fund Manager Liable for Securities Fraud in Connection with PIPE Investments (SEC v. Berlacher), SEC Litigation Release No. 21,648 (Sept. 14, 2010); SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010).
The confidentiality agreement entered into by each investor with the issuer should prohibit explicitly trading on the basis of material non-public information. Even if it does not, the SEC staff has made clear its view that trading on the information while subject to a duty of confidentiality is sufficient to form the basis for an insider trading action: "Question: If an issuer gets an agreement to maintain material nonpublic information in confidence, must it also get the additional statement that the recipient agrees not to trade on the information in order to rely on the exclusion in Rule 100(b)(2)(ii) of Regulation FD? Answer: No. An express agreement to maintain the information in confidence is sufficient. If a recipient of material nonpublic information subject to such a confidentiality agreement trades or advises others to trade, he or she could face insider trading liability. [Aug. 14, 2009]" SEC Staff, Division of Corporation Finance, Compliance and Disclosure Interpretations: Regulation FD, Question 101.05, *available at* www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm (last updated June 4, 2010).

have not yet been registered. Although the SEC's view did not prevail in these cases,[86] it continues to adhere to it.[87]

Accordingly, market participants have continued to hedge in a manner consistent with the SEC's position by (i) waiting before hedging to avoid statutory underwriter concerns, and (ii) engaging in "double print" transactions. Double printing refers to purchasing shares in the market to close out a short position (delivering those shares to the purchaser in the short sale or the stock lender that provided shares initially used to settle the short sale). The restricted securities acquired in the PIPE are sold in the market roughly contemporaneously, but with sufficient time between the trades so that they are separate and the investor is subject to some market risk.[88]

§ 1:4.9 Registered "PIPEs"—Registered Direct Offerings

"Registered direct" offerings are sometimes referred to as "registered PIPEs." Registered direct offerings are similar to PIPEs, but the offered securities are already registered under an effective shelf registration statement, so there is no need for the two-step process of a private placement and registered resale. Like a PIPE, a registered direct offering is marketed to a select group of investors on a best efforts basis. Unlike a PIPE, the securities may be offered and sold to non-AI investors because the offering is public and the securities will not be restricted. As a result, there should not be much of a liquidity discount. This can make registered directs very attractive both to the issuer and to investors with shorter time horizons for their investments.

§ 1:5 Rights Offerings

§ 1:5.1 Overview

In a rights offering, an issuer's existing shareholders receive the opportunity to purchase, on a pro rata basis, newly issued shares of the issuer's common stock at an exercise price typically set at a significant discount to the market price of the common stock. Rights offerings have historically been common in Europe because of statutory preemptive right requirements.[89] They have been less common in the United States, where they are considered a less favorable way to raise capital and associated with smaller or distressed companies.

A rights offering can be a useful way for issuers of any size or financial condition to raise capital. In contrast to a large PIPE, for example, a rights offering can raise a substantial amount of capital and avoid shareholder approval requirements (because it is a public offering for cash), significant corporate governance concessions (because there is no individual negotiation), and change of control triggers (because the likelihood of a change is low, as contrasted with a concentrated issuance to a small set of investors). A rights offering may also appeal to an issuer when markets are volatile, and the issuer's valuation is down. Existing shareholders may have a stronger, more enduring view of the issuer's value and offer

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[86] *See* SEC v. Lyon, 529 F. Supp. 2d 444, 459 (S.D.N.Y. 2008); SEC v. Mangan, 598 F. Supp. 2d 731, 733 n.5 (W.D.N.C. 2008); *see also* SEC v. Berlacher, Fed. Sec. L. Rep. (CCH) P96,738 (E.D. Pa. 2012).

[87] *See* SEC Staff, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections, Question 239.10, *available at* www.sec.gov/divisions/corpfin/guidance/sasinterp.htm (last updated Nov. 13, 2020) ("An issuer filed a Form S-3 registration statement for a secondary offering of common stock which is not yet effective. One of the selling shareholders wanted to do a short sale of common stock 'against the box' and cover the short sale with registered shares after the effective date. The issuer was advised that the short sale could not be made before the registration statement becomes effective, because the shares underlying the short sale are deemed to be sold at the time such sale is made. There would, therefore, be a violation of Section 5 if the shares were effectively sold prior to the effective date. [Nov. 26, 2008]").

[88] The SEC has accepted this approach as consistent with its views. *See, e.g., In re* Spinner Asset Mgmt., LLC, Securities Act Release No. 33-8763 (Dec. 20, 2006); Complaint at 2, SEC v. Berlacher, No. 07-3800 (E.D. Pa. Sept. 13, 2007).

[89] European statutory preemptive rights can in certain circumstances be sidestepped with appropriate board or other approval or pursuant to another available exception, thereby facilitating a more traditional follow-on equity offering by the issuer.

cheaper financing than new investors. Existing holders may also appreciate the opportunity to maintain their pro rata positions in the issuer at a discount, or the chance to sell transferable rights if they do not want to invest further.

Rights offerings have been used in bankruptcy to facilitate an issuer's exit from proceedings under Chapter 11 of the U.S. Bankruptcy Code. A rights offering can allow the issuer to raise cash to pay off creditors, permit creditors to exchange their debt for equity, or allow existing equity holders to inject cash and retain their equity position in the reorganized issuer.[90]

§ 1:5.2 Structure

In a rights offering, rights are issued to existing shareholders at no cost as of a specified record date. The rights entitle the shareholders to buy additional shares, based on a set subscription ratio of a number of new shares for each right, at a given exercise price during a fixed subscription period. Assuming a shareholder exercises its rights fully, the shareholder will not be diluted by the rights offering. Specific points such as the exercise price, subscription ratio, transferability of the rights, and the involvement of an underwriting or backstop commitment for unsubscribed shares can affect the attractiveness of the offering and the likelihood of its success.

The issuer will usually work with third parties to help in the offering process. A broker-dealer serves as the dealer-manager. The dealer-manager helps develop the marketing strategy for the rights offering and solicit the exercise of rights. If the rights are transferable, the dealer-manager may act as a market maker. A subscription agent—typically the issuer's transfer agent—disseminates the rights and related offering documents, such as a prospectus or prospectus supplement, collects subscription forms and related payments from exercising shareholders, and calculates participation. An information agent handles questions and requests for further information about offering logistics.

[A] Exercise Price and Subscription Period

The issuer will set the exercise price at a discount sufficiently low to attract investors, while not low enough to risk adverse perceptions in the market or jeopardize its financing goals. Determinations of the price must balance the concentration of the issuer's shareholder base and the likelihood of shareholder participation, the amount of dilution to non-exercising shareholders, recent market conditions, and the volatility of the stock price. The dealer-manager assists the issuer with fixing the price, the subscription ratio, and other terms for the offering. The subscription period often lasts two to four weeks after the rights are granted. A rights offering may include an "over-subscription" privilege that allows a shareholder that exercises its rights in full to subscribe for additional shares if there are any unexercised rights.

[B] Transferability

Rights may or may not be transferable by the shareholders. Transferability promotes more exercise of the rights by allowing interested investors to purchase the rights and invest in the issuer's stock at a discounted price.[91] If the rights are transferable, the issuer usually lists them for trading during the subscription period on the same securities exchange as the underlying common stock.[92] If the rights are not transferable, a holder that does not exercise its rights will be diluted without any compensation.[93]

[90] The U.S. Bankruptcy Code contains a special exemption from Securities Act registration for the issuance of securities by an issuer in Chapter 11. In general, Section 1145 exempts from registration the issuance of securities pursuant to a bankruptcy plan where the securities are issued principally in exchange for existing claims or equity.

[91] Some investors use a so-called "tail swallow" structure whereby they sell just enough rights to cover the exercise price for their remaining rights.

[92] *See* NYSE Listed Company Manual, § 703.03(N).

[93] *Id.* Section 703.03(N) touches on this point: "The Exchange considers it highly desirable, from the standpoint of public interest, that dealings in subscription rights, and in the security being offered, be conducted in the same market as the beneficiary security, where all three will be subject to the same market conditions and will be affected thereby in proper relative proportions. There is the further consideration that the subscription right represents a

[C] Underwriting or Backstop Commitments

In a non-underwritten and non-backstopped rights offering, the issuer bears the risk that shareholders will not subscribe in full for the shares. If crucial to raise a certain amount of capital in the offering, the issuer may arrange an underwriting or backstop commitment to purchase any shares not subscribed for during the subscription period (sometimes referred to as the "rump" shares).

In an underwriting, one or more broker-dealers would be engaged, usually led by the dealer-manager of the offering. Alternatively, investors, such as one or more existing major shareholders of the issuer, may agree to provide a backstop or standby commitment. In contrast to traditional underwriters that want to earn a fee from placing the shares and not be left with a stake in the issuer, backstop providers are interested in acquiring a stake or augmenting their existing position.[94] Underwriters will be paid a fee, and backstop providers will almost always also receive a fee for their commitment.[95] Backstop providers sometimes commit to buy more shares in a private placement alongside the rights offering at the subscription price. In addition, backstop providers often obtain registration rights to facilitate their ability to resell any shares they acquire.[96]

§ 1:5.3 Legal and Regulatory Considerations

[A] Shareholder Approval and Large Holder Considerations

Potential shareholder approval is a key consideration in a rights offering.[97] Any concerns related to shareholder approval should be discussed with the securities exchange in advance because the exchanges do not have written rules that cover shareholder approval in rights offerings.[98] A rights offering of 20% or more of the outstanding common stock, and with no underwriting or backstop commitment, should not require shareholder approval insofar as it is a public offering for cash. The use of underwriting or backstop

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realizable part of the market value of the beneficiary security, and where the latter is listed on the Exchange, it is appropriate that shareholders desirous of selling their subscription rights be afforded the facilities and benefits of the Exchange auction market for that purpose."

[94] In some cases, both traditional underwriters and backstop providers may provide commitments.

[95] In some cases, the backstop provider will forgo a fee because it is a major shareholder and focused principally on restoring the issuer to financial viability or views the opportunity to purchase additional shares at a discount pursuant to the backstop as sufficient.

[96] Traditional underwriters should be able to sell rump shares pursuant to the rights offering registration statement, and the possibility of their doing so should be described in the plan of distribution. For backstop providers, the backstop is tantamount to a private placement of securities to them, resulting in their acquiring restricted securities at closing and thereby needing a resale registration statement (or an exemption from registration) to be able to sell freely. Because backstop providers, as selling shareholders, bear some risk of being treated as statutory underwriters (*see supra* note 74) they may well negotiate for typical underwriter protections in the registration rights agreement (*e.g.*, due diligence rights, as well as the right to receive legal opinions, 10b-5 letters and comfort letters). Traditional underwriters also sometimes implement a so-called "Shields Plan" to help manage their underwriting risk. A Shields Plan involves purchases by the broker-dealers of rights during the rights trading period, combined with sales of a corresponding amount of shares underlying the rights. Such a plan should be permissible under Regulation M, which replaced certain rules that more heavily regulated rights offerings: "In light of the treatment of derivative securities under Regulation M, the Commission is rescinding Rule 10b-8, which pertained to distributions through rights. This rule contained overly rigid and complex restrictions on purchases of rights and regulated sales of offered securities. Bids for and purchases of rights are not subject to Rules 101 and 102, although bids for and purchases of a security that is the subject of a rights distribution are restricted by these rules." Anti-manipulation Rules Concerning Securities Offerings, Securities Act Release No. 33-7375; Exchange Act Release No. 34-38067; Investment Company Act Release No. IC-22412 (Dec. 20, 1996) (adopting Regulation M).

[97] *See supra* Sections 1:3.4[C], § 1:4.6.

[98] NYSE Listed Company Manual, Section 703.03(A) in fact urges issuers to contact the NYSE well in advance of a rights offering: "Because of the complexity encountered in rights offerings and the necessity for arranging a time schedule which will coordinate the various actions to be taken, it is recommended that the company confer with their Exchange representative well in advance of the offering date."

arrangements, however, could change this conclusion in some circumstances (*e.g.,* where the underwriter or backstop providers earn a fee or where a backstop provider is a substantial securityholder).

As with any offering of securities, but particularly in a rights offering, given the large number of shares issued, the issuer must confirm it has sufficient authorized share capital.

To the extent a rights offering results in the issuance of significant number of shares to a single holder, particularly an underwriter or backstop provider, the offering can raise many of the same issues as a PIPE. Accordingly, the offering participants must consider whether the rights offering could cause a change of control or trip a relevant regulatory threshold. Investors will need to analyze potential obligations under Section 13 and Section 16.[99] Underwriters and backstop providers, especially existing stockholders that come together to support the rights offering, must consider if they may have formed a "group" for purposes of Sections 13 and 16, and accordingly must treat themselves as the beneficial owners of each other's securities.[100]

[B] SEC Registration

Although the grant of rights in itself is for no consideration, the purchase of shares pursuant to the exercise of rights is an offer of those shares and must be registered.[101] As noted above, a backstop provider will often also obtain registration rights to facilitate its ability to resell any shares it acquires.[102]

A rights offering by a foreign private issuer may be exempt from the registration requirements of the Securities Act pursuant to Rule 801 under the Securities Act. This exemption is available if 10% or less of the class of stock in respect of which rights are being issued is held of record by U.S. holders and applies only to all-cash rights offerings made on a pro rata basis to all shareholders of the class (including American Depositary Receipts (ADRs) evidencing the shares). The exemption provided by Rule 801 is available to issuers only, and underwriters are not able to rely on the exemption for resales of any rump shares. Accordingly, any such shares sold in the United States must be privately placed with QIBs or AIs. In addition, rights issued to U.S. shareholders under Rule 801 are not transferable except outside the United States in accordance with Regulation S. The shares underlying the rights, though, are freely transferable in the United States so long as the shares in respect of which the rights are issued are unrestricted securities. The issuer must also consent to service of process in the United States. A rights offering under Rule 801 is not subject to liability under Sections 11 and 12(a)(2) of the Securities Act, but it is subject to Section 10(b) of, and Rule 10b-5 under, the Exchange Act.[103]

In circumstances where Rule 801 is not available or not feasible to use, and SEC registration is impractical or undesirable, a foreign private issuer may choose to exclude U.S. holders from participating in a rights offering, or extend the rights offering to U.S. holders only on a private placement basis, subject to any applicable constraints under non-U.S. laws. In these cases, the issuer would arrange for the rights to be sold

[99] Traditional underwriters should be able to look to Rules 13d-3(d)(4) and 16a-7 under the Exchange Act for some measure of protection in this regard. The former provides that a person engaged in business as an underwriter that acquires the securities through participation in good faith in a firm commitment SEC-registered underwriting will not be deemed the beneficial owner of the securities until 40 days after the date of the acquisition. The latter similarly exempts from Section 16 reporting purchases and sales made in connection with a distribution of a substantial block of securities in good faith in the ordinary course of business.

[100] In general, a group is formed "[w]hen two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer." Exchange Act Rule 13d-5(b)(1).

[101] As with any public offering involving FINRA members (*i.e.*, essentially any U.S. broker-dealer), it may be necessary to make a filing under FINRA Rule 5110 unless an exemption is available. *See supra* Section 1:3.4[B].

[102] A traditional underwriter should be able to sell rump shares pursuant to the rights offering registration statement, and the possibility of its doing so should be described in the plan of distribution. *See supra* note 96.

[103] *See supra* notes 41 and 42 and accompanying text.

for the benefit of U.S. holders (other than any U.S. holders participating by way of private placement) and remit the cash to them.

[C] Securities Exchanges

Both the NYSE and NASDAQ have rules about rights offering, including about the provision of notices and the choice of record date.[104] These rules are in addition to any shareholder approvals that must be obtained in connection with a rights offering. The NYSE has more extensive rules, procedures, and guidance relating to rights offerings, though NASDAQ generally applies similar principles. For example, the NYSE generally requires a minimum of ten calendar days' advance notice of the record date and subscription price and a subscription period that runs at least sixteen days,[105] while NASDAQ does not have specific requirements on these points.

Because rights offerings bring unique structuring considerations, coordination with the exchanges in advance is critical. The mechanics of rights offering mechanics can be particularly challenging for shares that trade on multiple exchanges—for example, where a foreign private issuer is listed both in its home country and through ADRs in the United States—because the rules and procedures in each jurisdiction often conflict at least to some degree. With sufficient advance coordination, these conflicts can usually be resolved to all parties' satisfaction.

§ 1:6 Conclusion

When a public issuer contemplates a follow-on equity offering, it must evaluate both market conditions and its own financing needs. As markets and issuers change over time, the optimal method may change as well. Based on those factors and the relationships it seeks with investors, agents, and underwriters, an issuer can evaluate ATM offerings, registered and exempt block trades, PIPEs, registered direct offerings, and rights offerings to decide which approach best fits its circumstance.

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[104] *See, e.g.*, NYSE Listed Company Manual, § 703.03 (governing rights offering for NYSE-listed securities); NASDAQ Stock Market Rules, Rule 11140.

[105] The subscription period can be shortened to 14 days in certain circumstances. *See* NYSE Listed Company Manual, § 703.03(E).