ALERT MEMORANDUM

Post-IPO Liquidity Roadmap for Pre-IPO Equity Investors

January 4, 2024

The following roadmap guides pre-IPO equity investors in U.S. companies through typical legal considerations in executing post-IPO liquidity transactions. This is only an overview, however, and counsel should be consulted well in advance of any transactions to ensure full compliance with law and vetting of commercial considerations. (Similar concerns apply to investments in non-U.S. companies and already public companies, but, again, counsel should be consulted to discuss relevant factors.)

Because the types of transactions available to an investor depend on whether the securities are freely transferable or subject to securities law and contractual restrictions, this roadmap begins by reviewing these key concepts. It then discusses common trade types and legal issues that may arise.

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I. **KEY TERMS & CONCEPTS**	
A. Lock-up	1. **Purpose.** The underwriters obtain lock-ups to reduce downward pressure on share price following the IPO. 2. **Concept.** A lock-up is a contractual restriction for the benefit of the IPO underwriters on transferring and hedging shares (and securities convertible into shares), usually for 180 days post-IPO. 3. **Timing.** Pre-IPO investors often commit to enter into a lock-up well in advance of a potential IPO as part of making their investment (*e.g.,* in an investors' rights agreement). a. Investors sometimes are subject to other contractual restrictions that limit their ability to resell their securities freely – *e.g.,* long-term lock-ups directly with issuers, "atomization" agreements that preclude reselling positions

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	exceeding a certain size to any one buyer, and limitations on sales to competitors of the issuer.
B. Restricted and Control Securities	1. **Purpose.** SEC registration generally aims to ensure the public has full disclosure when making an investment decision in securities. Exemptions from registration reflect that investors are sophisticated and can fend for themselves, or that a transaction is tantamount to ordinary course trading and does not involve a "distribution" of securities to the public. 2. **Securities Act Registration.** Every offer or sale of securities generally must be registered with the SEC under Section 5 of the Securities Act or exempt from registration. a. The registration of an offer or sale is different than registering a class of shares under the Exchange Act (*e.g.,* in connection with listing the class on the NYSE or Nasdaq). 3. **Rule 144.** Rule 144 provides a non-exclusive safe harbor to resell restricted securities and control securities without SEC registration into the public market. Depending on certain facts (*e.g.,* when the securities were acquired, the type of transaction in which they were acquired, and who holds them), securities can be restricted securities, control securities, both or neither. See the **Annex** for a Rule 144 flow chart. a. More specifically, Rule 144 creates a safe harbor from the definition of "underwriter" in Section 2(a)(11) of the Securities Act by establishing criteria for when a person is not engaged in a distribution. b. An investor satisfying the criteria, and therefore not an underwriter, is eligible for the exemption from SEC registration in Section 4(a)(1) of the Securities Act for "transactions by any person other than an issuer, underwriter, or dealer." 4. **Restricted Securities.** Securities that are privately placed by an issuer (*e.g.,* exempt from registration pursuant to Section 4(a)(2) of, or Regulation D under, the Securities Act) or privately sold by an affiliate of the issuer (*e.g.,* under Section 4(a)(7) or Section "4(a)(1 ½)" of the Securities Act) are considered "restricted securities" under Rule 144. a. Restricted securities cannot be freely resold into the public market prior to a "seasoning" or "holding" period of six months or one year, unless their resale is registered with the SEC. i. The holding period is six months if: (A) the issuer has been an Exchange Act-reporting company for at least 90 days;

(B) the issuer has filed its Forms 10-K and 10-Q during the 12 months preceding the sale or such shorter period the issuer was required to file (Form 8-K does not matter for this purpose); and

(C) the seller has not been an affiliate for the three months before the sale.

ii. The holding period is one year if these conditions are not met.

5. **Control Securities.** Securities that are held by an "affiliate" of the issuer – regardless of whether they are acquired in a private placement or in the public market – are considered "control securities."

a. Control securities cannot be freely resold into the public market without meeting certain conditions specified in Rule 144, unless their resale is registered with the SEC.

b. The conditions allow the holder to "dribble out" the securities. They generally:

i. require that the issuer make available certain specified current public information about itself;

ii. require the filing by the holder of a Form 144 with the SEC indicating proposed sales;

iii. impose manner of sale restrictions designed to mimic ordinary course secondary market trades; and

iv. impose a volume limit on sales equal to the greater of:

(A) 1% of the outstanding securities of the class being sold; and

(B) the average weekly reported volume of trading in the four weeks preceding the filing of the Form 144.

6. **Affiliate Status.** 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.

a. This is a fuzzy standard, but a person generally is presumed to be an affiliate if it is a holder of > 10% of voting equity or a director (or an investor that appoints a director) of the issuer.

b. This presumption may be rebutted with facts showing that the person does not control the issuer (*e.g.,* larger holders of the voting equity or a controlling shareholder).

7. **Practical Considerations.**

   a. By the time a 180-day lock-up expires, restricted securities generally will have seasoned.

   b. However, the securities still will be control securities if held by an affiliate, and therefore subject to the volume, manner and other restrictions described above.

      i. Notwithstanding that Rule 144 does not by its terms grant a safe harbor for affiliates selling control securities that are not restricted securities (*e.g.,* because acquired by an affiliate in the public market and not in a private placement), under longstanding doctrine based on the text of the Securities Act, these securities may be resold immediately once the holder ceases to be an affiliate.

      ii. The three-month non-affiliate rule nonetheless still applies to seasoned restricted securities, such as those purchased in a pre-IPO private placement and held for longer than the holding period.

II. RESALE OPTIONS

A. Resale Options

1. **Private Sale.** Unseasoned restricted securities may be resold privately to "accredited investors," but often this is unappealing because the buyer will step into the remaining six-month or one-year, as applicable, holding period for restricted securities.

   a. In addition, a buyer of securities in a private sale from an affiliate must commence a new holding period under Rule 144.

2. **Registered Sale.** The securities may be resold publicly through SEC registration. Only the issuer of the securities can register the securities for resale.

   a. Pre-IPO investors therefore typically obtain registration rights (in an investors' rights agreement or separate registration rights agreement) that require the issuer to register their securities for resale.

   b. Registration rights do not always include the right to force an issuer to conduct an IPO, but frequently do allow investors to "piggyback" or participate proportionately in an IPO.

   c. Each SEC-registered sale must be accompanied by a prospectus filed by the issuer, which must be materially accurate and complete. An issuer generally will not be in a position to update its registration statement (of which the prospectus is a part) during a blackout as it prepares its upcoming quarterly or annual results release.

   d. Additionally, even for post-IPO sales, the SEC registration process can take time. Holders therefore typically require the issuer to establish and maintain

	an effective shelf registration statement that facilitates rapid offerings (or "takedowns"). i. Public companies generally are eligible to use "short-form" Form S-3 shelf registration one year after going public. ii. Form S-3 facilitates a greater range of resale options for holders (*e.g.,* block trades), in contrast to Form S-1, which is what an issuer otherwise must use. e. Banks participating in SEC-registered sales generally will need to conduct due diligence on the issuer to protect themselves from liability. Depending on their familiarity with the issuer and the type of transaction, this effort can be more or less significant and should be factored into the timetable accordingly. **3. Rule 144 Sales.** Alternatively, the securities may be freely resold under Rule 144 if they are seasoned (for restricted securities) and subject to Rule 144's volume and manner restrictions and current public information and Form 144 filing requirements (if they are control securities). a. Restricted securities usually bear "restrictive legends" that cannot be removed without an opinion of counsel or representations from the holder to the transfer agent regarding the availability of Rule 144. b. It is important to build in time to work with the issuer and transfer agent to effect "delegending" when planning a sale under Rule 144. Investors' rights agreements and registration rights agreements often require the issuer to cooperate with this process.
B. Trade Types	**1. SEC-Registered Trades.** SEC registration can be used to effect the following: a. Ordinary course brokerage sales into the market from time to time. i. In contrast to the other types of transactions described below, this does not require the use of a prospectus supplement for the sales, and therefore does not require issuer involvement other than for putting up the initial prospectus. (A prospectus supplement is a deal-specific SEC filing made in connection with a particular takedown.) ii. However, banks may impose limits on the volume of these types of sales absent the opportunity to conduct diligence on the issuer and obtain supporting legal opinions and comfort letters. b. A more organized "at-the-market (ATM)" or "dribble-out" program where banks are engaged to facilitate sales into the market at preset parameters over a specified period (including using a "10b5-1 trading plan," described further below).

c. A block trade (or "bought deal") where a bank buys a block of securities at a discount to the closing market price before engaging in marketing efforts and attempting to resell it quickly overnight. (An auction sometimes is conducted by the selling investor to generate competitive bids for the block discount.)

d. A marketed underwritten offering involving issuer cooperation (*e.g.,* a brief road show) and a more traditional book-building process by the underwriters.

e. An over-the-counter derivative transaction may be used to monetize or hedge the shares without currently selling them. For example, in a variable prepaid forward, the investor protects itself against downside risk on the shares below a floor price and forgoes upside over a cap. The investor also can receive an upfront payment based on the floor price of the derivative.

   i. To hedge the transaction, the dealer sells the number of shares underlying the derivative under a registration statement at the time of entry into the transaction.

   ii. At maturity, the transaction can be settled by delivery of shares or payment of cash based on the then-current value of the shares.

   iii. The transaction can often be structured to avoid a current sale of the shares for tax purposes.

2. **Rule 144 Trades.** Rule 144 can be used to effect the following trades (subject to the holding period requirement for restricted securities and, for control securities, the volume and manner restrictions and current public information and Form 144 filing requirements):

a. Ordinary course brokerage sales into the market from time to time.

b. A block trade.

c. An over-the-counter derivative transaction, such as a variable prepaid forward, with a dealer (in which case the dealer will sell shares to establish its hedge pursuant to Rule 144).

d. A "reverse ASR" or "VWAP+ sale", where the investor sells shares to a dealer in an over-the-counter forward transaction, at a price determined based on the volume-weighted average price (VWAP) during the course of an averaging period (typically determined by the dealer). The dealer can elect to cut off the averaging period early (generally subject to a minimum period), and may pay a price greater than the average VWAP.

e. A "distribution in kind" where a partnership (including a partnership managed by an affiliate of the issuer) distributes portfolio company

securities to LPs, pro rata to their LP interests and for no consideration from the LPs.

i. Non-affiliate LPs generally can tack the Rule 144 holding period of the partnership and resell the securities freely (assuming the holding period has run).

ii. Affiliate LPs generally can sell subject to Rule 144 rules applicable to affiliates, including aggregation of the sales volume of the partnership and all affiliate LPs for purposes of Rule 144.

3. Margin Loans. Rather than selling shares, an investor may monetize its shares by entering into a loan on them – very often a margin loan. In the typical margin loan, a lender agrees to lend a percentage of the market value of the shares, and may make "margin calls" for additional collateral if the shares fall in value below a specified threshold.

i. For margin loans on concentrated positions, lenders may request a bankruptcy remote special purpose vehicle to be the borrower to address certain insolvency risks.

ii. If shares are restricted, lenders may request an agreement with the issuer to assist with delegending and foreclosing on shares.

iii. A variable prepaid forward transaction (described above) or certain other derivative structures permit monetization without the requirement to meet margin calls if the shares fall in value.

III. <u>REGULATORY CONSIDERATIONS</u>

A. Exchange Act Section 13(d)

1. Purpose. The Section 13(d) regime aims to inform the market about the accumulation of significant stock ownership positions. It was adopted in the 1960s as part of a broader effort to regulate cash tender offers.

2. Beneficial Ownership. "Beneficial ownership" (whether individually or as a "group," described below) of > 5% of any class of SEC-registered voting equity securities triggers a Schedule 13D (long-form) or 13G (short-form) reporting obligation.

a. A beneficial owner is a person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares voting or investment (including dispositive) power over a security.

b. A person generally is deemed a beneficial owner of a security if the person has the right to acquire beneficial ownership within 60 days, including through a convertible security or similar right.

c. However, if the person acquires the security or right with the purpose or effect of changing or influencing control over the issuer, the 60-day

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limitation does not apply and the person is deemed the beneficial owner immediately upon obtaining a right to acquire shares.

3. Beneficial Ownership “Blockers.” Passive investors in convertible securities that wish to avoid exceeding a specified percentage ownership (e.g., 5% or 10%) often employ a contractual “blocker,” where the issuer agrees that the holder may not convert its security for more than the specified percentage (unless the holder otherwise requests with at least 61 days’ notice).

4. Group. A “group” is formed when two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, even in the absence of a written agreement or intent to form a group. The group is deemed to have acquired beneficial ownership of all the securities beneficially owned by its members.

5. Schedules 13D and 13G. A Schedule 13D must be filed after crossing the 5% threshold, unless the holder is eligible for Schedule 13G. Schedule 13G is available to three types of holders:

a. Pre-IPO investors.

i. Pre-IPO investors can continue reporting on Schedule 13G if they acquire no more than 2% of the class within a 12-month period.

b. “Passive” investors holding < 20% of the class.

c. “Qualified Institutional Investors” (generally, regulated entities such as investment advisers and broker-dealers) that are passive.

6. Filing Deadlines. The filing deadlines were amended in October 2023. Detailed rules also govern the required amendments to Schedules 13D and 13G, and the obligation to switch from a Schedule 13G to a Schedule 13D (e.g., passive investors developing a control intent or exceeding 20%).
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<td>B. Exchange Act Section 16</td>
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1. Purpose. The Section 16 regime aims to prevent corporate “insiders” from unfairly using confidential information to profit from trading in the issuer’s securities. Section 16 does not apply to insiders of foreign private issuers.

a. A company incorporated outside the United States may qualify as a “foreign private issuer,” which carries certain registration and disclosure benefits not available to U.S. domestic companies. Under Securities Act Rule 405 and Exchange Act Rule 3b-4, a non-U.S. company will qualify as a foreign private issuer if 50% or less of its outstanding voting securities are held by U.S. residents; or if more than 50% of its outstanding voting securities are held by U.S. residents and none of the following three circumstances applies: (i) the majority of its executive officers or directors are U.S. citizens or residents; (ii) more than 50% of the issuer’s assets are located in the United States; or (iii) the issuer’s business is administered principally in the United States. Companies incorporated outside the United States that do not qualify
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as foreign private issuers must comply with the same securities law requirements as U.S. domestic companies, including Section 16.

2. **Insider Status.** An investor becomes a Section 16 "insider" if it beneficially owns > 10% of any class of SEC-registered voting equity securities of a U.S. issuer (whether individually or as the result of collective ownership with other members of a group) or has a director seat at a U.S. issuer.

    a. An investor, such as a private equity sponsor or hedge fund, can be deemed a "director by deputization" where it appoints a director who effectively serves at the behest of, and reports to, the investor. In those cases, the investor, and not just the director, is subject to Section 16, even if the investor beneficially owns < 10%. The investor separately may be subject to Section 16 if it is a > 10% beneficial owner. (Executive officers of U.S. issuers also are subject to Section 16, but it would be unusual for an investor to appoint an officer.)

    b. Section 16 obligations apply to all classes of equity securities of the issuer in which the insider has a "pecuniary interest." A pecuniary interest generally is having or sharing the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in a security, and includes interests in securities convertible or exchangeable into equity securities and derivatives (including cash-settled derivatives) on equity securities.

3. **Insider Ownership Reports.** Under Section 16(a), insiders generally must file:

    a. A Form 3 as an initial report of ownership, generally within 10 days of acquisition, except that pre-IPO holders must file upon effectiveness of the Exchange Act registration statement for the relevant securities (typically at the time of the IPO pricing).

    b. A Form 4 report for most transactions within two business days.

    c. A Form 5 within 45 days of end of calendar year to report a very limited set of transactions.

4. **Short-Swing Profit Rule.** Under Section 16(b), absent an exemption, an insider is required to disgorge to the issuer profits (or deemed profits) resulting from "short-swing" trading in the issuer's equity securities.

    a. A short-swing trade generally is any purchase and any sale (or vice versa) that are made by an insider within six months of each other. Complex rules govern the Section 16 regime for purchases and sales, including in the context of derivatives.

    b. Important exemptions exist from short-swing disgorgement requirements, including for trades by a director (including a director by deputization) directly with the issuer and the exercise of certain derivatives.

C. Exchange Act Section 13(f)	**1. Purpose.** The Section 13(f) regime was adopted in 1975 to increase the public availability of information regarding the securities holdings of institutional investors, with a view to promoting investor confidence in the integrity of U.S. securities markets. **2. Form 13F.** Form 13F must be filed by "institutional investment managers" with investment discretion over ≥ $100 million of "13(f) securities." a. If, as of the last trading day of any month of any calendar year, the $100 million threshold is met or exceeded, the institutional investment manager is required to file Form 13F to report its holdings in those securities. b. The form discloses 13(f) securities positions as of the end of each quarter. **3. Filing Deadlines.** The deadline for the initial filing is within 45 days after the last day of that calendar year and within 45 days after the last day of each of the first three calendar quarters of the subsequent calendar year. **4. Institutional Investment Manager.** An "institutional investment manager" is any entity that either invests in, or buys and sells, securities for its own account, even if it is not principally in the business of managing investments. This includes banks, insurance companies, broker-dealers, corporations and pension funds that manage their own portfolios. It does not include natural persons. **5. 13(f) Official List.** The SEC publishes an "official list" of 13(f) securities each quarter. The list essentially covers exchange-listed securities.
D. Exchange Act Section 13(h)	**1. Purpose.** The Section 13(h) regime is designed to facilitate the SEC's ability to identify, and collect information on the trading activity of, the most significant participants in the U.S. markets. **2. Form 13H.** Exchange Act Rule 13h-1 requires "large traders" to file with the SEC a confidential Form 13H identifying themselves and the broker-dealers through which they effect trades. (The broker-dealers must tag large traders' trades with a large trader identification number (LTID) assigned by the SEC.) **3. Large Trader.** A "large trader" is any person that directly or indirectly exercises investment discretion over one or more accounts and effects transactions for the purchase or sale of equity securities listed on a U.S. exchange or standardized options that meet or exceed the "identifying activity level." a. "Identifying activity level" means aggregate transactions in these securities that are equal to or greater than:

	i. during a calendar day, either 2 million shares or shares with a fair market value of $20 million; or ii. during a calendar month, either 20 million shares or shares with a fair market value of $200 million. **4. Filing Deadlines.** Form 13H is required to be filed: a. Promptly after first effective aggregate transactions equal to or greater than the identifying activity level; b. Within 45 days after the end of each calendar year; and c. Promptly following the end of a calendar quarter in the event that any information contained in a Form 13H filing becomes inaccurate for any reason.
E. Rule 10b-5 / Material Non-Public Information (MNPI)	**1. MNPI.** An investor generally should not trade, publicly or privately, while in possession of material non-public information (MNPI). a. Investors with directors on the board often choose to have their directors resign post-IPO to avoid being tainted with MNPI and thereby restricted from trading. b. Similarly, information rights that afford investors MNPI pre-IPO typically terminate upon IPO. c. In certain limited circumstances, it may be possible for an investor to trade with a counterparty that has access to the same MNPI as the investor. i. Counsel should be consulted in these circumstances. ii. Issues may arise with trading securities using a “big boy” letter. A big boy letter is an acknowledgment by a counterparty that the investor has MNPI that the counterparty does not have. Big boy provisions are not a bar to SEC enforcement and may violate the anti-waiver provisions of the Exchange Act. **2. 10b5-1 Trading Plans.** An investor might consider establishing a “10b5-1 trading plan” that would allow the investor to establish parameters, or to delegate trading discretion to a third party, for future trading during periods when the investor has MNPI. a. Investors often choose not to adopt these plans, however, given the desire to maintain control over their trading. (Although a plan can be terminated at any time, doing so can call into question the good faith required under Rule 10b5-1 for the plan’s adoption and administration.) b. Adopting a 10b5-1 plan also involves a number of administrative steps that can be cumbersome – *e.g.,* doing so only while not in possession of MNPI

	and observing a long cooling-off period – up to 120 days for directors and officers, and 30 days for others, except for the issuer itself – before trading can begin. Under recently adopted rules, U.S. issuers also must make quarterly disclosure of trading plans entered into by directors and officers.

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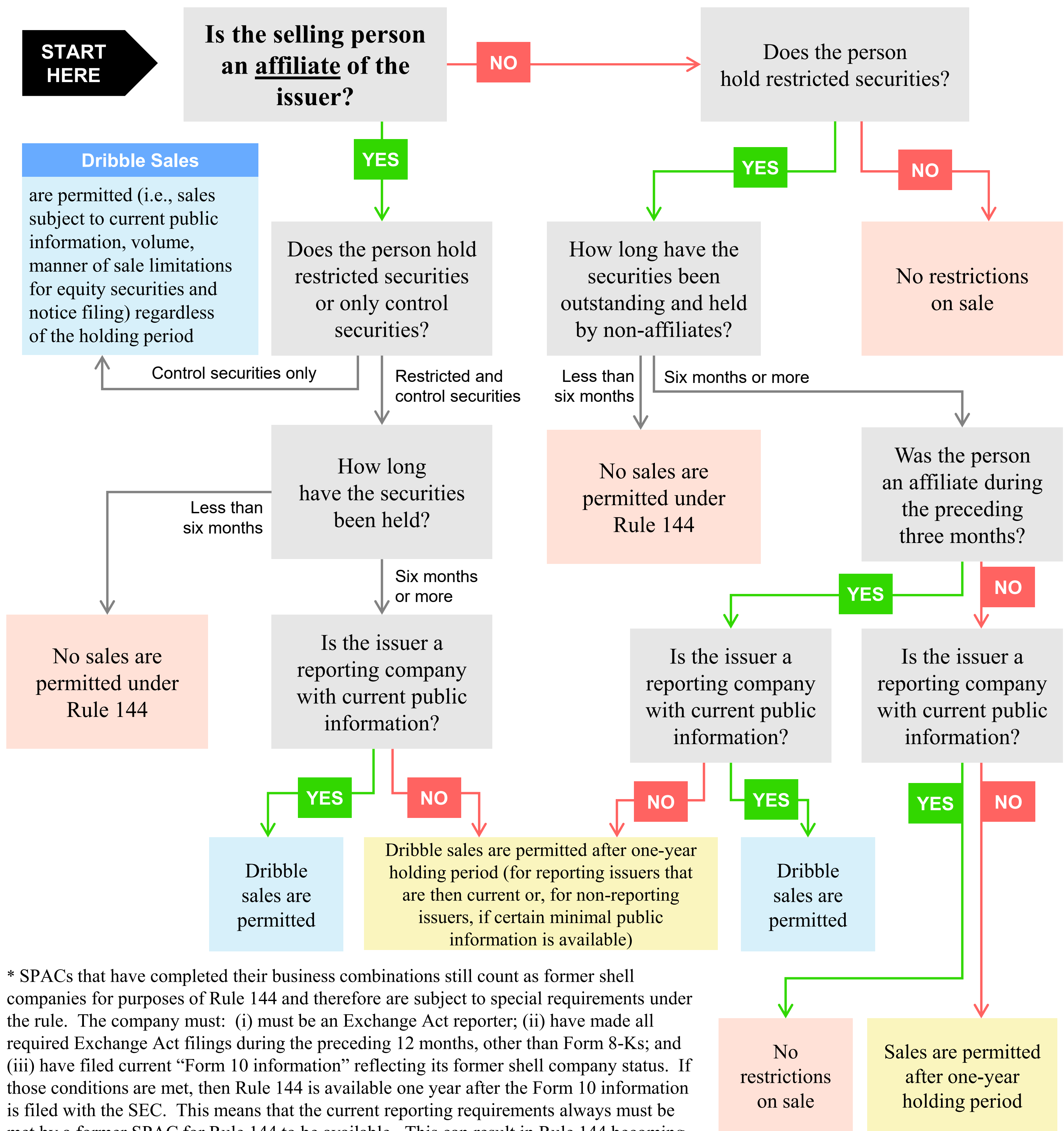
Annex: Rule 144 Flow Chart*



* SPACs that have completed their business combinations still count as former shell companies for purposes of Rule 144 and therefore are subject to special requirements under the rule. The company must: (i) must be an Exchange Act reporter; (ii) have made all required Exchange Act filings during the preceding 12 months, other than Form 8-Ks; and (iii) have filed current "Form 10 information" reflecting its former shell company status. If those conditions are met, then Rule 144 is available one year after the Form 10 information is filed with the SEC. This means that the current reporting requirements always must be met by a former SPAC for Rule 144 to be available. This can result in Rule 144 becoming unavailable unexpectedly if the issuer misses a required report and can make delegending of restricted securities more complicated to achieve on a blanket basis.