MAYER | BROWN

WHAT'S THE DEAL?

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About Our Practice

We are one of the leading securities and capital markets law firms in the world, advising issuers, underwriters and agents in domestic and international private and public financings.

Our practice is diverse, spanning the financing continuum—from private placements, to IPOs, to 144A and Reg S offerings, to continuous issuance programs, like MTN and CP programs, to derivatives, structured products and structured finance and securitization transactions. We also represent issuers and SPACs on initial business combinations, as well as advising in connection with SPAC PIPE transactions, and related matters.

We advise privately held companies and public companies, as well as placement agents, in connection with private placements of equity, equity-linked and debt securities. We count among our capital markets lawyers innovators in the private placement and PIPE market.

In addition, we regularly counsel companies, placement agents, private investors, and strategic investors in connection with mezzanine or late-stage private placements. Given the depth of our experience with private placements and IPOs, we are able to work effectively with our clients on these transactions while remaining focused on their strategic objectives and longer-term financing plans.

While we have exceptional credentials in many areas, we count as among our greatest strengths our global network, and our ability to marshal our resources and bring them to bear on complex cross-border transactions—joining together with a shared commitment to practical and timely advice.

At-the-Market ("ATM") Offerings

Here's the deal:

- An "at-the-market" ("ATM") offering is an offering of securities into an existing trading market for the securities at a price or prices related to the then-market price of the securities.
- ATM offerings are continuous offerings, and provide issuers with a flexible way to raise modest amounts of capital with minimal market impact, at a low cost and with limited management involvement.
- ATM offerings are often utilized by issuers that have a frequent need to raise capital, whether to repay debt, fund the purchase price for a small acquisition or otherwise fund operations.

What's the Deal?

An ATM offering is a follow-on offering of securities utilized by publicly traded companies in order to raise capital over a period of time. In an ATM offering, an issuer sells newly issued shares into the trading market through a designated sales agent at prevailing market prices. These offerings are conducted pursuant to an equity distribution or sales agreement entered into between the issuer and one or more sales agents. The sales agent may act either on an agency (best efforts) or principal (firm commitment) basis; however, more often than not, transactions are undertaken on an agency basis.

Advantages of ATM Offerings

ATM offerings offer several advantages over traditional follow-on offerings, including:

- **Minimal market impact** Issuers can quickly raise capital by selling newly issued shares into the natural trading flow of the market, without having to market and/or announce the offering. As a result, shares are able to "trickle" into the market without significant impact on stock price.
- **Flexibility** Sales can be effected on an agency or principal basis, and the terms of each sale are agreed upon between the issuer and the sales agent, including the timing and size, at the issuer's discretion. This enables an issuer to match its issuances to its ongoing needs. For example, an issuer can implement a limit price below which sales will not occur and/or a percentage limitation on daily sales to reduce downward price pressure on its stock.
- **Low cost** The distribution costs for ATM offerings (usually 1-3%) typically are lower than the fees associated with traditional follow-on offerings.
- **Minimal management involvement** ATM offerings require no "roadshows."

- **Forward sale option** Many ATM offerings have been structured to incorporate a forward sale option. A forward sale allows an issuer to sell its securities through the ATM offering at the current trading price without actually issuing any securities to satisfy the forward commitment until a future settlement date.

Disadvantages of ATM Offerings

ATM offerings tend to be substantially smaller than traditional follow-on offerings, and may not be as useful to issuers seeking to raise a large amount of capital within a short period of time. There are ongoing costs associated with the maintenance of an ATM program, which may seem substantial if the issuer is not making ATM offerings regularly.

Required Filings with the Securities and Exchange Commission

An issuer must have an effective shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers) on file with the Securities and Exchange Commission (the "SEC"). The issuer can either (i) use an allocated portion of an already existing universal shelf registration statement specifically for ATM programs or (ii) prepare a new shelf registration statement specifically for an ATM program. If the issuer decides to use an already existing shelf registration statement, then the issuer must prepare a prospectus supplement specifically for the ATM program. The plan of distribution section included in the shelf registration statement, or in the related prospectus supplement, must describe the general terms of the ATM program, including the method of sale and commissions/fees to be paid by the issuer, and identify the sales agents that will participate in the ATM program.

Upon execution of the equity distribution or sales agreement governing the ATM program, the issuer will file with the SEC the prospectus supplement, as well as a current report on Form 8-K, which will include as an exhibit, the equity distribution or sales agreement. In addition, the issuer must report quarterly the number of shares sold under the ATM program, as well as the commissions paid and net proceeds to the issuer, either by means of a prospectus supplement or in the issuer's periodic reports.

Often an ATM program will allow the issuer to conduct block trades, which trades are effected at a fixed price. To the extent that an issuer conducts a block sale, it might consider and discuss with counsel whether a prospectus supplement relating to the transaction should be filed.

Eligibility

A public company is eligible to implement an ATM program if it has a public float of at least $75 million or satisfies certain other qualifying thresholds. A company that qualifies as a well-known seasoned issuer ("WKSI") will have greater flexibility. A WKSI may file an automatically effective shelf registration statement and is not required to specify an aggregate dollar amount on the registration statement. As a result, a WKSI may access the market promptly after filing its registration statement. An issuer that is not a WKSI, and that does not have an effective shelf registration statement, will need to file a registration statement, which may be subject to SEC comment, that specifies the number of securities to be registered.

An issuer that has an aggregate market value of common equity held by non-affiliates of less than $75 million, will be subject to Instruction 1.B.6(a) of Form S-3, which limits the amount the issuer can offer to up to one-third of the public float during any trailing 12-month period. This one-third limitation will apply to securities sold in any primary offering, including an offering made pursuant to the ATM program. For issuers that are subject to this "baby shelf" rule, the full amount available under an ATM program (even the portion that remains unsold) counts against the one-third limitation, which can be quite punitive.

To calculate the public float for purposes of S-3 eligibility, an issuer may look back 60 days and select the highest of the last sales prices or the average of the bid and ask prices on the principal exchange. The registration capacity for a baby shelf is measured immediately prior to the offering and re-measured on a rolling basis in connection with subsequent takedowns. The shelf availability for a particular takedown is measured as the current allowable offering amount less any amounts actually sold under the shelf registration statement in prior takedowns. Accordingly, the available offering amount will increase as an issuer's stock price increases, and decrease as an issuer's stock price decreases.

Required Documentation

The equity distribution or sales agreement, entered into between the issuer and the sales agent(s), establishes the terms and conditions upon which the issuer and sales agent will conduct the ATM offering. The agreement typically provides for both agency and principal transactions, sets forth the sales agent's commission, and contains representations, warranties and covenants from the issuer to the sales agent, as well as indemnification, contribution and termination provisions. The equity distribution or sales agreement typically terminates on either a fixed date or when the offering amount is reached.

The equity distribution or sales agreement usually requires the delivery to the sales agent of legal opinions (including a negative assurance from issuer's and agent's counsel), an officer's certificate, and a comfort letter from the issuer's independent auditors. Generally, the agreement also will require that the issuer bring-down its representations and warranties at the time of each sale, as well as periodic updates to the issuer's deliverables to the sales agent.

Due Diligence Obligations

An ATM offering is a registered public offering. The sales agent and its counsel will conduct due diligence prior to the entry into the equity distribution or sales agreement and the commencement of the ATM offering. As discussed above, given the ongoing or continuous nature of the offering, the equity distribution or sales agreement will require that the issuer refresh or provide updated deliverables, including updates to the legal opinions and comfort letter.

The sales agent may be subject to liability under Section 11 of the Securities Act, even though it may be acting as an agent only on a best efforts basis, which means that the level of due diligence required is the same as that for any underwritten follow-on offering.

Executing ATM Sales

The sales agent generally will execute sales of the issuer's securities through ordinary brokers' transactions through securities exchanges or electronic trading systems at varying prices. These transactions do not involve any special selling efforts (i.e., no roadshow or other active solicitation) nor do they involve an amount of the issuer's securities that would be considered significant relative to the issuer's public float or daily trading volume. The commission payable by the issuer to the sales agent is consistent with the commission payable to a dealer executing trades rather than the type of fee that would be associated with underwriting compensation. Based on these various factors, the sales agent's execution of ATM offerings more closely resembles ordinary dealer activity than participation as an underwriter in a securities distribution.

Regulation M

Regulation M is intended to prohibit manipulative practices in the securities offered in a distribution. Rule 101 of Regulation M prohibits distribution participants and their affiliated purchasers from directly or indirectly bidding for, purchasing or attempting to induce another person to bid for or purchase the subject security or any reference security until the applicable restricted period has ended. Rule 102 of Regulation M prohibits issuers, selling security holders and their affiliated purchasers from directly or indirectly bidding for, purchasing or attempting to induce another person to bid for or purchase the subject security or any reference security until the applicable restricted period has ended.

An ATM offering of securities that qualify as "actively traded" (i.e., average daily trading volume ("ADTV") of at least $1 million for an issuer with a public float of at least $150 million) is not subject to the restrictions of Rule 101. However, the restrictions of Rule 102 still apply to the issuer, any selling security holders and affiliated purchasers, unless the subject security is not issued by the issuer or any affiliate and the subject security has a reference security that itself qualifies as "actively traded." Generally, most ATM offerings are conducted for issuers that meet the ADTV test. In the case of securities that do not meet this exception, it will be important to undertake a closer analysis of the Regulation M restrictions.

Note that Rule 104 of Regulation M prohibits stabilization activities in connection with ATM offerings. In addition, ATM offerings are "best efforts" offerings, which are exempt from the short sale restrictions of Rule 105 of Regulation M.

The Financial Industry Regulatory Authority ("FINRA") requires sales agents to file Regulation M Restricted Period Notification Forms and related Regulation M Trading Notification Forms if the relevant transaction is considered a "distribution" as defined in Regulation M. In most cases, as discussed above, because the issuer's securities qualify as "actively traded," a restricted period is not imposed. However, to determine whether a proposed ATM offering is considered a distribution, Regulation M requires an analysis of factors that may distinguish the proposed offering from ordinary trading activity, such as the magnitude of the offering, the presence or absence of special selling efforts and methods, the number of shares to be sold, the percentage of outstanding shares of the proposed offering compared to the public float and the security's normal trading volume.

Rule 10b5-1 Plans

An affiliate of an issuer may utilize a Rule 10b5-1 trading plan in conjunction with an ATM offering as a means of disposing of its securities. Any person or entity executing preplanned transactions pursuant to a Rule 10b5-1 plan that was established in good faith at a time when that person or entity was not aware of material non-public information has an affirmative defense against accusations of insider trading, even if actual trades made pursuant to the plan are executed at a time when the individual or entity may be aware of material non-public information.

In order to benefit from the safe harbor, a Rule 10b5-1 plan incorporated into an ATM offering must:

- specify the amount, price (which may include a limit price) and specific dates of purchases or sales; or
- include a formula or similar method for determining amount, price and date; and
- give the sales agent the exclusive right to determine whether, how and when to make purchases and sales, as long as the sales agent does so without being aware of material nonpublic information at the time the trades are made.

Compliance Considerations for Sales Agents

Sales agents participating in an ATM program should consider, among other things, how to address their participation in an ATM program with respect to any restricted or watch lists. Using watch and restricted lists may permit the sale agent's compliance and legal departments to monitor the firm's activities relating to the issuer, including research activities, and initiate proper conflict resolution procedures.

A sales agent generally can participate in an ATM offering even if it already provides research coverage regarding the issuer or plans to provide such coverage in the future. Rule 139(a) of the Securities Act permits a sales agent that participates in a distribution of securities of an issuer meeting the eligibility requirements of Form S-3 to publish a "research report" regarding the issuer or any class of its securities without having the research report considered an "offer" or a non-conforming prospectus, provided that the research report is included in a publication distributed with reasonable regularity in the normal course of the sales agent's business. Additionally, the "research report" must include similar information, opinions or recommendations with respect to a substantial number of companies in the issuer's industry or subindustry, or contain a comprehensive list of securities currently recommended by such sales agent and the research covering the issuer is given no materially greater space or prominence than that given to other securities or companies.

In those instances where the sales agent does not already provide research coverage, a question may arise whether the sales agent can commence research coverage during the term of the ATM offering. Since there is little guidance to rely on, it is helpful to analogize and rely on the regulatory guidance regarding the commencement of research coverage preceding a follow-on public offering. A FINRA member cannot publish a research report on an issuer for which the FINRA member acted as a manager or co-manager of a follow-on offering by the issuer for three calendar days following the date of the offering. In this case, the sales agent may consider instituting a policy that it will not commence research coverage or provide a research report for a period of not less than three calendar days following the establishment of an ATM offering.

Sales agents must consider and institute guidelines regarding the review process that should be undertaken regarding research on the securities of issuers for which it is acting as an agent.
These guidelines should include procedures for handling research reports that discuss earnings projections or a change in credit rating, as well as those reports issued outside the sales agent's regular course of business.

Checklist of Key Questions

- Does the issuer have enough authorized and unissued shares to accommodate the number of shares that may be issued in connection with the ATM offering?
- Is there a shelf registration statement available or must a new registration statement be filed?
- Is the issuer subject to Form S-3's baby shelf limitation?
- Will the ATM offering program include multiple sales agents?
- Will the ATM program be structured to incorporate the ability to undertake block sales?
- What are the quarterly diligence deliverables that are expected in connection with the ATM offering?
- What restrictions does Regulation M impose on the issuer and the sales agent?
- Has the issuer considered whether a forward sales agreement would be useful in connection with the ATM offering?

Medium Term Note ("MTN") Programs

Here's the deal:

- MTN programs are designed to enable frequent debt issuers to access the market quickly, without the burden of negotiating a suite of takedown documents for each debt issuance.
- MTN programs may be either registered with the Securities and Exchange Commission ("SEC") or exempt from registration, such as in Section 3(a)(2) bank note programs, Rule 144A and Regulation S programs.
- MTN program documents typically include a distribution or program agreement (which provides a framework for continuous offerings, as opposed to an underwriting agreement used in individual offerings), a fiscal agency agreement or indenture, and ancillary documents such as a calculation agency agreement.
- MTN offerings settle and clear in the United States through the issuance of securities in global, book-entry form, and are held by direct and indirect participants of The Depository Trust Company ("DTC").

What's the Deal?

Medium-term note ("MTN") programs enable companies to offer and sell a wide range of debt securities, which may have similar or different terms, on a periodic and/or continuous basis, by using pre-agreed offering and distribution documents and a simplified clearing process. With an MTN program, the issuer is able to use streamlined documentation for each offering and rely on the master program documentation and disclosure documents.

MTN programs were historically developed by the commercial paper departments of investment banks and often were administered by a bank's specialty group rather than through the typical relationship bankers. Most of these offerings are made on a principal or agency basis through the MTN broker-dealer's trading desk. MTNs having tenors of between two to five years were conceptualized as a means to bridge the gap between short-term commercial paper maturing in nine months or less, and long-term debt securities maturing 30 years or more from the issuance date. However, it is not unusual for issuers to issue both short-term and long-term securities under an MTN program.

In light of the convenience offered by shelf registration and MTN programs, issuers use MTN programs (i) to effect small- and medium-sized offerings of debt securities to investors that seek specific terms such as a specified principal amount, with a specified credit rating and a specified maturity (known as reverse inquiry trades); (ii) to effect large syndicated offerings of debt securities that might, in the absence of an MTN program, be offered through a traditional shelf takedown; (iii) to offer structured notes, such as equity-linked, index-linked, currency-linked and commodity-linked securities; and (iv) to operate a retail MTN program wherein an issuer offers MTNs with small minimum denominations to the retail investor market, while limiting administrative costs to the issuer to acceptable levels. In one type of retail MTN program, an issuer will post rates weekly with retail and/or regional brokers. During the week that these rates are posted, the brokerage firms that market the securities to retail investors will place orders in the applicable minimum denominations. At the end of the week, the retail and regional brokerage firms will contact the issuer and indicate the aggregate amount of orders for notes at each maturity, and the issuer will issue one series of notes for each maturity.

Offered Securities

MTN securities historically were principally fixed-rate, non-redeemable senior debt securities and eventually evolved to include other types of debt securities, including floating rate, zero coupon, non-US dollar denominated, amortizing, multi-currency, subordinated or indexed securities. Common reference rates for floating rate securities issued under MTN programs include secured overnight financing rate ("SOFR"), the interbank offered rates ("IBORs") (though, of course, these are being phased out), the prime rate, the Treasury rate, the federal funds rate and the constant maturity swap ("CMS") rate. Most MTN programs are rated investment-grade by one or more nationally recognized credit rating agencies.

MTNs are usually sold on a best efforts basis. However, competitive pressures may sometimes lead a dealer to purchase MTNs securities as principal, and large syndicated MTN offerings often are effected on a firm commitment basis. In both cases, the MTN dealer is usually regarded as an "underwriter" for liability purposes under Section 11 of the Securities Act of 1933 (the "Securities Act").

The traditional market for MTNs is investor-driven wherein dealers continuously offer MTNs within a specific maturity range, and an investor can negotiate to have the dealer meet its particular investment needs. In making their investment decisions, MTN investors consider credit ratings, an evaluation of the issuer and its business, and the maturity and yield of the MTNs

MTN Programs: SEC-Registered and Exempt

MTN programs generally are limited to larger public companies with at least a $75 million public equity float and are usually registered on a shelf registration statement under Rule 415 of the Securities Act, specifically under Rule 415(a)(1)(x) for continuous or delayed offerings of issuers that are eligible to use Form S-3 or Form F-3 on a primary basis, or under Rule 415(a)(ix) for continuous offerings of issuers that are not eligible to use Form S-3 or Form F-3 and cannot undertake delayed offerings. MTN programs may also be registered on Form S-1 or Form F-1, but this is rare.

Non-SEC reporting companies can also issue MTNs. MTN programs that are not required to be registered with the SEC include (i) bank note programs exempt from registration under Section 3(a)(2) of the Securities Act; (ii) Rule 144A programs in which the securities are offered exclusively to qualified institutional buyers; (iii) private placements made through continuous Section 4(a)(2) offerings; and (iv) Regulation S programs in which the MTNs are offered outside the United States. The issuer and the selling agents for these offerings may use a variety of term sheets to offer these MTNs, which are not subject to the filing requirements of the Securities Act.

Even though MTN offerings under Section 3(a)(2) are exempt from registration under the Securities Act, they are public securities offerings conducted by banks and must be filed with the Financial Industry Regulatory Authority, Inc. ("FINRA") for review under Rule 5110(a)(2) when there is a FINRA member involved in the distribution, unless the issuer has outstanding investment grade rated unsecured non-convertible debt with a term of issue of at least four years, or the non-convertible debt securities are so rated. Transactions under Section 3(a)(2) and Rule 144A must also be reported through FINRA's Trade Reporting and Compliance Engine, or TRACE, to provide greater transparency for investors.

MTN Program Participants

The working group involved in establishing an MTN program generally includes:

- **Issuer** which usually will be a large corporate or financial services issuer, which has an ongoing need for capital and that is eligible to file a shelf registration statement for delayed and continuous offerings, as well as government-sponsored entities, such as Fannie Mae and Freddie Mac;
- **Guarantor** (in some cases), such as the issuer's subsidiary or a special purpose finance subsidiary, which may have a higher credit rating on its indebtedness than the issuer;
- **Arranger** which is usually an investment bank that (i) serves as principal selling agent for the MTNs; (ii) advises the issuer as to potential financing opportunities in the MTN market; (iii) communicates to the issuer any offers from potential investors to buy MTNs; (iv) advises the issuer as to the form and content of the offering documents, including the types of securities to be included; (v) negotiates the terms of the agreements on its own behalf and on behalf of the other selling agents; (vi) coordinates settlement of the MTNs with the issuer, the trustee and the paying agent; and (vii) makes a market in the issued and outstanding securities under the MTN program;
- **Selling Agents** other than the arranger, are often added to an MTN program if not at establishment, then, through an accession letter, which is a short form of agreement between the issuer and the new selling agents that makes the new selling agents parties to the existing MTN program agreement. Selling agents may be added for the entirety of the program or as dealers for a day to participate in a specific MTN offering. Having multiple selling agents fosters competition among the selling agents to market the issuer's MTNs, and helps to attract more reverse inquiry transactions that may likely bring down the issuer's financing costs;
- **Regional dealers** (in some cases) may be included by the selling agents, and, if so, are paid by selling agents through selling concessions;
- **Law Firms** acting as counsel to the issuer and to the investment banks and, at program establishment, to the trustee or fiscal and paying agent;

- **Accounting firm** which audits the issuer's financial statements and is expected to deliver a comfort letter at the establishment of the program and then from time to time as required under the distribution agreement;
- **Rating agencies** (typically at least two) that will provide credit ratings to the issuer's indebtedness generally or credit ratings that are specific to notes issued pursuant to the MTN program;
- **Trustee or fiscal and paying agent** serves a variety of roles, including (i) processing payments of interest, principal and other amounts on the MTNs from the issuer to the investors; (ii) communicating notices from the issuer to the investors; (iii) coordinating settlement of the MTNs with the issuer and the selling agent; (iv) assigning security identification codes to the MTNs (in the case of US programs, the trustee typically obtains a block of CUSIP numbers for the relevant issuer's MTN program and assigns them on an issue-by-issue basis); (v) processing certain tax forms that may be required under the MTN program; and (vi) in the case of a trustee of a series of US-registered MTNs, acting as representative of the investors in the event of any claim for payment if a default occurs;
- **Listing agent** if the relevant MTNs are to be listed or the program is to be qualified for listing on a securities exchange, usually a European securities exchange;
- **Clearing systems** such as DTC, Euroclear and Clearstream; and
- **Financial printer** to the extent printing is required.

MTN Program Documentation

The offering documents for a registered MTN program may include a "universal" shelf registration statement for debt and other securities, or a shelf registration statement relating only to debt securities. The base prospectus, which is included in the registration statement, will include a general description of the issuer's debt securities that may be issued as well as the possible benchmark rates that may be referenced, and any other potential terms of the securities that are then known. For an exempt MTN program, the offering document will be an offering circular or offering memorandum, rather than a base prospectus, with a form of pricing supplement or final terms to be used for individual offerings made pursuant to the program. In the structured notes context, there may be a need to file a more detailed prospectus supplement describing the notes to be issued under the MTN program, and free writing prospectuses and/or pricing supplements, each of which will include the specific details of each offering or each type of note that may be issued pursuant to the program.

An issuer and the selling agent may also use several other disclosure documents in the offering process, including preliminary and final term sheets, subject to the filing requirements of Rule 433 and other SEC rules relating to "free writing prospectuses" to negotiate the terms of an offering with potential investors, to market an offering, or to set forth the agreed-upon final terms of an offering; free writing prospectuses that may be brochures or other educational materials, and websites and other types of documents used to market potential offerings from an MTN program; product supplements for issuers of structured products to describe the detailed terms, risk factors and tax consequences of a particular type of product to potential investors; and press releases, particularly in the context of syndicated offerings.

If not otherwise filed with the registration statement, the issuer must also file:

- the **distribution agreement** entered into with the selling agents, which also may be called a "program agreement" or a "sales agency agreement" designed to provide for multiple offerings during the term of the MTN program, and typically includes (i) representations and warranties of the issuer, deemed to be made both at the time of the signing of the agreement and at the time of each takedown, as to the accuracy of the offering documents, the authorization of the applicable issuance documents and the indenture or fiscal and paying agency agreement; (ii) the steps to be followed if the MTN prospectus supplement is amended or the size of the program is increased; (iii) the steps to be followed, and the approvals required, if any free writing prospectuses are to be used; (iv) requirements as to the conditions precedent, documents and deliverables required to establish the MTN program and/or conduct takedowns, which may be reverse inquiry transactions, or agented or syndicated takedowns; (v) requirements as to any subsequent deliverables from the issuer to the selling agents, such as periodic comfort letters, legal opinions and officer's certificates; (vi) provisions allocating program expenses among the issuer and the selling agents; (vii) indemnification of the selling agents for liabilities under the securities laws; (viii) provisions relating to the determination of the selling agents' compensation or a schedule of commissions; and (ix) provisions for adding additional selling agents, whether for the duration of the program or for a specific offering. Beginning on January 1, 2019, US global systemically important banks and their subsidiaries began adding stay provisions in their securities contracts, such as the distribution agreement. These arose from the qualified financial contract ("QFC") stay rules requiring "covered entities" to include standardized contractual stay language in their QFCs in order to mitigate the risk of destabilizing closeouts of their QFCs, which could be an impediment to an orderly resolution of such financial institutions if there were a failure of such institutions.
- the **indenture** duly qualified under the Trust Indenture Act of 1939 (in the case of an SEC-registered program), which is usually open-ended, does not limit the amount of debt securities that can be issued, and may have restrictive covenants, affirmative covenants and events of default; or *paying agency agreements* (in the case of an exempt or unregistered program);
- an **administrative procedures memorandum**, which is usually an exhibit to the distribution agreement and describes the exchange of information, settlement procedures and responsibility for preparing documents among the issuer, the selling agents, the trustee or paying agent, and the applicable clearing system in order to offer, issue and close each series of securities under the MTN program;
- a **calculation agency agreement** wherein the calculation agent, oftentimes the trustee or the paying agent, agrees to calculate the rate of interest due on floating rate notes;

- an **exchange rate agency agreement** wherein the exchange rate agent, which may be the trustee or paying agent, will, in the case of notes with payments to be made in a non-US currency, convert the non-US currency into US dollars;
- an **Exhibit 5.1 opinion** about the legality of the notes to be issued under the program;
- in the case of complex securities, an **Exhibit 8.1 opinion** on the disclosure of the US federal income tax consequences of investing in the MTNs; and
- the **form of the master note or certificate representing the MTNs** which typically is in global form, with a single master certificate representing each series, and for more efficient takedowns, containing detailed provisions that could apply to many different types of notes (fixed and floating; the calculation of different types of base rates) and a short leading page or cover page for the note that indicates (through check boxes and blank lines) which of those detailed terms are applicable to the specific issuance.

Depending upon the arrangements between the issuer and the selling agents, some or all of the comfort letters, opinions and officer's certificates called for by the distribution agreement will be required to be delivered to the selling agents on a periodic basis as part of the ongoing due diligence process because the selling agents are subject to liability as "underwriters" under Section 11 of the Securities Act as noted above. These "deliverables" will help the underwriters establish a "due diligence" defense against any potential Section 11 claims against them for misstatements or omissions in the offering documents.

An MTN program takedown is intended to be relatively straightforward since the distribution or program agreement and the principal governing documents were negotiated and agreed when the program was established. The issuer and the arranger (and the other selling agents, if applicable) will agree on the terms of the takedown, commonly done orally with written confirmation to follow; and the agents will deliver the base prospectus, MTN prospectus supplement and pricing supplement to investors (which may occur via "access equals delivery" under SEC Rule 172 in the case of a registered program). In the case of a syndicated MTN issuance, an updated comfort letter, legal opinions and one or more officers' certificate are also provided to the selling agents at the closing of the offering. For a registered offering, the issuer will file with the SEC under Rule 424 a pricing supplement containing the title of the securities, issue date, maturity date, interest rate, any redemption dates, the names of the underwriters or selling agents and their compensation for the offering, and the legal opinion language. The issuer will also instruct the trustee or issuing and paying agent to complete the form of the note or certificate representing the MTNs in global or certified form.

Checklist of Key Questions

- Is the establishment of an MTN program consistent with the issuer's financing needs, taking into consideration the costs and process for periodic deliverables and due diligence?
- Does the issuer's board of directors and pricing committee understand the MTN program structure?
- Does the base prospectus or offering circular describe the range of potential benchmark rates that may be used by the issuer? Are there provisions regarding the transition away from IBOR rates?
- If there is a limit specified in the MTN prospectus supplement, is there a sufficient amount available for issuance taking into consideration both the amounts authorized and issued?
- Are the selling agents acting on a best efforts or firm commitment basis?
- Is the selling agent an affiliated broker-dealer of the issuer? If so, are the potential conflicts of interest disclosed in the manner required by FINRA rules?
- Is the MTN program rated investment grade to exempt the issuer from FINRA's Rule 5110 review?
- What documents will be required to be delivered on a quarterly (or other periodic) basis by the issuer to the selling agents?
- What documents are required to be negotiated and entered into in connection with a syndicated offering?
- If there is no selling agent for a particular issuance, has the issuer made arrangements for DTC settlement through the trustee?

Private Investment in Public Equity ("PIPE") Transactions

Here's the deal:

- A PIPE transaction is a private placement undertaken by an already public company.
- Typically, the investors in PIPE transactions are institutional accredited investors and qualified institutional buyers ("QIBs").
- The issuer engages a placement agent to identify investors, wall cross these investors and have the investors agree to certain confidentiality undertakings and to refrain from trading in the issuer's securities for a period of time. The subscription agreement between the issuer and each of the investors include, among other things, a commitment on the issuer's part to file and have declared effective, within particular time frames, a resale registration statement.
- The resale registration statement covers the resale from time to time of the securities purchased by the investors in the PIPE transaction.
- A PIPE transaction can be completed relatively quickly and efficiently and may be the best financing alternative in a number of instances.

Introduction

Market volatility is now the norm. Financing "windows" often open and close rather abruptly, and issuers must be prepared to undertake a capital-raising transaction quickly. Often, a PIPE transaction can be executed during periods when the public markets may not be open or particularly hospitable.

What's the Deal?

A PIPE transaction refers to a private placement of a public issuer's equity or equity-linked securities to investors, where a resale registration statement covering the resale from time to time by the PIPE investors of the securities purchased in the PIPE transaction is made available by the issuer.

A PIPE transaction is marketed by the issuer's placement agent to potential investors that have been wall-crossed and that have agreed to confidentiality and a trading restriction. As a result, an issuer will be able to assess whether there is interest in a transaction on terms that are attractive to the issuer and to enter into definitive purchase agreements before the issuer makes any public announcement. This is important in order to avoid investor front-running among other things.

Private Investment in Public Equity ("PIPE") Transactions

A PIPE transaction is structured as a private placement made pursuant to the Section 4(a)(2) statutory private placement exemption under the Securities Act of 1933 (the "Securities Act") and possibly Rule 506(b) of Regulation D.

Why a PIPE transaction?

A PIPE transaction often is simply the most cost-effective alternative for many issuers especially during periods of heighted market volatility. While incurring substantially lower transaction expenses than it would in a public offering, an issuer will also expand its base of accredited and institutional investors through the PIPE transaction.

A PIPE transaction permits an issuer to raise capital quickly. Investors receive only very streamlined offering materials or information, including publicly filed Securities Exchange Act of 1934 ("Exchange Act") reports, unless there is a new, recent development or other material nonpublic information ("MNPI").

As noted above, a PIPE transaction will be disclosed to the public only after definitive purchase commitments are received from investors, and generally will close and fund within two to five days of receiving definitive purchase commitments. In a PIPE transaction, investors may expect a discount to the current market price to reflect the liquidity discount since initially investors receive "restricted securities" and will not have access to the resale registration statement for some period of time.

Comparing a PIPE transaction with Other Financing Alternatives

In comparing a PIPE transaction against other potential financing options, an issuer should generally consider that:

- it is the investor not the issuer which bears the market risk
- sophisticated institutional investors are familiar, and the US Securities and Exchange Commission ("SEC") is comfortable, with the PIPE format
- PIPEs typically involve a modest discount to market price
- PIPEs do not have any of the negative effects often associated with a "death spiral" offering, or an equity line of credit
- unless the PIPE is executed in connection with an acquisition or in a distressed environment, generally PIPE investors will not expect to have any ongoing affirmative covenants
- representations and warranties expected from the issuer will be quite consistent with those given by an issuer in its underwritten public offerings
- PIPE investors generally will not ask to and will not want to receive any MNPI (other than the mere fact that the issuer is contemplating a financing)

PIPE transactions may have some disadvantages, such as:

- the discount to the market price that the investors would require in order to compensate for the initial resale restrictions

- the transaction may only be marketed to accredited investors
- certain investors will not agree to be wall-crossed
- the issuer's inability to sell more than 20% of its outstanding stock at a discount without receiving prior stockholder approval
- a limit on the issuer's number of "black-out" (or suspension) periods while the resale registration statement is effective

Participants in PIPE Transactions

Companies that are reporting companies may consider a PIPE transaction.

The universe of potential investors is limited to accredited investors. Accredited investors include hedge funds, mutual funds, pension funds, sector and institutional buyers, venture funds and private equity firms. Distressed funds and venture funds have also begun participating in PIPE transactions.

There is no limit on the number of offerees in a PIPE transaction, so long as the placement agent is not engaging in any marketing or sales activity that would constitute a general solicitation.

The issuer will engage a placement agent to assist usually on an exclusive basis in identifying potential investors. The placement agent will play an essential role in wall crossing potential investors and ensuring that the investors agree to confidentiality undertakings before the name of the issuer is shared. The potential investors also will be required to agree to refrain from trading in the issuer's securities for a specified period of time.

Offering Materials

In a PIPE transaction, investors may receive a private placement memorandum; however, in many instances, the private placement memorandum will be quite limited and may contain principally the issuer's Exchange Act documents. Investors generally will not receive other MNPI.

Securities Offered in PIPE Transactions

In a typical PIPE transaction, investors enter into a purchase agreement that irrevocably commits them to purchase a fixed number of securities at a fixed price, not subject to market price or fluctuating ratios. Securities sold in a PIPE transaction are usually common stock, convertible preferred stock, convertible debentures, warrants, or other equity or equity-linked securities. Most PIPE transactions involve the sale of common stock at a fixed price, often with warrants.

Negotiation Points in PIPE Transactions

The price is set through discussions between the placement agent and the issuer, just as it is during the course of an underwritten (firm commitment) offering.

The price risk in a fixed priced transaction is borne by the purchaser during the period from execution of the purchase agreement until the closing.

The purchase agreement will contain a detailed set of issuer representations and warranties. These will cover matters relating to the authorization of the transaction and the issuance of the securities, the issuer's business and operations, the issuer's Exchange Act reports, the issuer's compliance with laws, non-contravention representations, and related matters. The issuer's representations may be negotiated with potential investors.

The purchase agreement will contain representations and warranties from the investor generally relating to the investor's authority to enter into the transaction documents, the status of the investors, the sophistication of the investors, the reliance on the part of the investor's on their own diligence and on the issuer's Exchange Act filings, and related matters. The investor also will be asked to reaffirm its confidentiality undertaking and its covenant not to trade in the issuer's securities until the transaction is publicly disclosed and any other MNPI shared with the investor is disclosed.

The purchase agreement will contain numerous covenants on the issuer's part, including the covenant to file a resale registration statement. Investors will negotiate the time period for the initial filing of the resale registration statement, the time period for addressing any comments from the SEC to declare effective the resale registration statement. The investor will negotiate penalty payments for failure to meet any of the specified milestones. In addition, the investor also will negotiate limitations on the number of blackout periods and the length of such periods, as well as the period during which the resale registration statement must be kept effective Finally, the investor may negotiate specific time periods in which the issuer will deliver an opinion to its transfer agent following the effectiveness of the resale registration statement to lift the restricted legend when the PIPE investor resells the securities.

The conditions to closing will not include any conditions that are within the purchaser's control. The issuer will be required to cause its counsel to deliver a legal opinion to the investors at closing.

Depending on the terms of the engagement letter between the issuer and the placement agent, the issuer may have other commitments to the placement agent, which may include a requirement to cause its counsel to deliver a reliance letter relating to the investor legal opinion.

The Resale Registration Statement

In connection with a PIPE transaction, an issuer typically must keep a resale registration statement effective for an agreed-upon period of time so that the securities may be sold freely, without reliance on Rule 144, by the PIPE investors. During this period, the issuer may suspend the use of the resale registration statement to amend it or to remedy a material misstatement or omission. This suspension is often referred to as a "black-out" period. During a black-out period, PIPE purchasers will have limited liquidity, as they will not be able to rely on the resale registration statement to sell the securities purchased in the PIPE transaction. Investors will negotiate a limit on the length and number of black-out periods.

If an issuer has a shelf registration statement on file, it is generally a primary shelf registration statement covering the sale by the issuer of its newly issued securities. The issuer must file and have declared effective a resale registration statement covering the resale by the PIPE purchasers (a selling stockholder shelf registration) from time to time of the securities that were purchased in the PIPE transaction.

The issuer does not need to be eligible to use a registration statement on Form S-3 ("Form S-3") on a primary basis in order to complete a PIPE transaction, but must be eligible to use Form S-3 on a resale basis.

The issuer may use a Form S-1 or a Form S-3 registration statement as a resale shelf registration statement in connection with a PIPE transaction. Nevertheless, an issuer should consider using a Form S-3 since it is more cost-effective and less time consuming than using a Form S-1, and is less burdensome and may be updated by the periodic filing of Exchange Act reports, without the need to file post-effective amendments.

In order to use the Form S-3 for resales (secondary shares), an issuer must (1)(i) be organized, and have its principal business operations in the United States or one of its territories; (ii) have a class of securities registered pursuant to Section 12(b) of the Exchange Act or a class of equity securities registered pursuant to Section 12(g) of the Exchange Act, or be required to file reports pursuant to Section 15(d) of the Exchange Act; and (iii) have been public and have timely filed all required filings for a period of at least 12 calendar months immediately preceding the filing of the Form S-3 and have filed all required reports in a timely manner; and (2) the issuer, and its consolidated and un-consolidated subsidiaries, must not, since the end of the last fiscal year for which certified financial statements of the issuer and its consolidated subsidiaries were included in an Exchange Act report: (i) have failed to make any required dividend or sinking fund payment on preferred stock or (ii) defaulted on the terms of any borrowing or on any long-term lease, which defaults in the aggregate are material to the financial position of the issuer and its consolidated and unconsolidated subsidiaries, taken as a whole.

Regulatory Approvals

A PIPE transaction does not require any prior approvals from regulatory agencies or self-regulatory organizations if the issuer does not issue more than 20% of its pre-transaction total shares outstanding at a discount and if the transaction does not represent a change of control or otherwise trigger approval requirements.

The issuer and its counsel should consider carefully the applicable securities exchange rules. The issuer should consider not only the effect of completing the proposed PIPE transaction, but also, if the issuer has completed other private transactions within the same six-month period, the aggregate effect of such transactions, all of which may be aggregated by the exchange.

The New York Stock Exchange ("NYSE"), the NYSE American, and Nasdaq have similar requirements, which we summarize briefly below, but which require a close look:

- Rule 312.03(c) of the NYSE Listed Company Manual requires that the issuer obtains shareholder approval prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if the common stock has, or will have upon issuance, voting power equal to, or in excess of, 20% of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock. Shareholder approval is not required under this rule if the common stock is sold in (a) any public offering for cash or (b) any bona fide private financing involving a sale of (i) common stock, for cash, at a price at least the "minimum price" or (ii) securities convertible into or, exercisable for common stock, for cash, if the conversion or exercise price is at least the "minimum price." "Minimum price" is defined as the lower of (i) the closing price of the issuer's common stock immediately before the execution of the transaction agreement and (ii) the average closing price of the issuer's common stock during the five days immediately preceding the transaction agreement.

- Section 713 of the NYSE American Company Guide requires that an issuer obtain shareholder approval for a transaction involving (1) the sale, issuance or potential issuance by the company of common stock (or securities convertible into common stock) at a "minimum price" which, together with sales by officers, directors or principal shareholders of the company, equals 20% or more of presently outstanding common stock; or (2) the sale, issuance or potential issuance by the company of common stock (or securities convertible into common stock) equal to 20% or more of presently outstanding stock for a "minimum price." "Minimum price" is defined as the lower of (i) the closing price of the issuer's common stock immediately before the execution of the transaction agreement and (ii) the average closing price of the issuer's common stock during the five days immediately preceding the transaction agreement.
- Rule 5635 of the Nasdaq Listing Rules requires that an issuer obtain shareholder approval in connection with a transaction other than a public offering, involving the sale, issuance or potential issuance at a "minimum price" by the issuer of common stock (or securities convertible into or exercisable for common stock), which alone or together with sales by officers, directors or substantial shareholders of the issuer, equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance. Rule 5635(d)(1)(A) defines "minimum price" as a price that is the lower of (i) the closing price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock (as reflected on Nasdaq.com) for the five trading days immediately preceding the signing of the binding agreement.

Shareholder approval also may be required by the rules of the securities exchanges for a private placement completed in connection with an acquisition, or a private placement that results in a change of control, or a private placement involving related parties.

PIPE Transactions: Traditional PIPE transaction compared to PIPE with Trailing Resale Registration Rights

While the PIPE format began with the so-called "traditional" PIPE transaction structure, which we describe below, most of the PIPE transactions that have been completed in recent years have taken the form of PIPE transactions with trailing resale registration statements.

A traditional PIPE transaction is a private placement of either newly issued shares of common stock or shares of common stock held by selling stockholders (or a combination of primary and secondary shares) of an already public company that is made through a placement agent to accredited investors wherein definitive purchase agreements are executed, the transaction is announced and the closing takes place only once the resale registration statement is to be declared effective by the SEC. Key differences are summarized on the next page.

Differences	Traditional PIPE Transactions	PIPE Transaction with Trailing Registration Rights
Structure	Through a definitive purchase agreement between the investors and the issuer in which the investors commit to purchase securities at a fixed price and the funding is conditioned on the availability of the resale registration statement.	Closing takes place promptly after entry into a definitive purchase agreement. The issuer has a post-closing obligation to file a resale registration statement and use its best efforts to have it declared effective.
Has control of the process	Placement agent. The placement agent conducts its own business and financial due diligence. Traditional PIPE purchasers generally do not negotiate for themselves ongoing negative covenants or covenants relating to information rights or corporate governance.	Placement agent or lead investor. Investors may limit their diligence to public filings.
Closing conditions (in general)	The issuer must update the representations and warranties made in the purchase agreement (which are similar to those contained in an underwriting agreement) and deliver a comfort letter and legal opinions (including a 10b-5 negative assurance relating to the private placement memorandum and the resale registration statement) to the placement agent; There can be no material adverse change since execution of the purchase agreement; and The SEC must have stated its willingness to declare the resale registration statement effective (which consequently makes available to investors a resale registration statement at the time of closing).	The purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement), which will be brought down at closing; For resettable or variable deals, the purchase agreement also may contain covenants requiring the future issuance of additional securities by the issuer at no cost to the purchaser; The purchase agreement may, depending on the nature of the purchaser, contain ongoing covenants relating to corporate governance (board representation or observer rights, blocking rights, etc.) or information requirements (regular deliveries of public filings or other information to the purchaser); The issuer must deliver a comfort letter and legal opinions to the placement agent; Each investor must deliver to the issuer and the issuer's transfer agent a certificate as to the investor's compliance with the prospectus delivery requirements in order to obtain unlegended stock certificates in the future; and There can be no material adverse change since execution of the purchase agreement
Mode of settlement	Outside of the Depository Trust Company ("DTC") system.	Outside of the DTC system.

Other Legal Concerns in PIPE Transactions

Regulation FD

The agents in a PIPE transaction (e.g., the placement agent, accountants and other participants in the PIPE process) owe a duty of trust or confidence to the issuer. Inasmuch as the issuer does not share any information with potential investors that has not already been included in its Exchange Act reports, the fact that the issuer is contemplating a PIPE transaction may oftentimes by itself constitute MNPI and the issuer will not want to be forced to make a premature disclosure regarding a financing. Hence, in compliance with Regulation FD, the issuer should ensure that, before the placement agent reveals the issuer's name, the placement agent obtains an oral or written agreement from each potential purchaser it contacts that information shared will be kept confidential, and that the agreement contains an explicit undertaking to refrain from trading in the issuer's stock. Considering that the issuer's contemplation of a PIPE transaction generally seeks to preserve its flexibility and only make a disclosure once definitive agreements have been executed, it is unlikely that an issuer will want to engage in any form of general solicitation, even if permissible.

Regulation M

Since most PIPE transactions are considered "distributions" for Regulation M purposes, the placement agent participating in a PIPE transaction must file a Regulation M notice with FINRA and refrain from making a market in the issuer's securities during the applicable Regulation M "restricted period," which is either one or five days prior to the pricing (as opposed to the funding or closing of the transaction) depending on the average daily trading volume of the issuer's security.

SEC Comments

The SEC Staff has issued comments to certain issuers (usually small cap issuers and issuers that have sold shares in excess of 33% of the total shares outstanding prior to the PIPE transaction, which is considered as "disproportionately large") that have filed resale registration statements to cover the resale of shares originally offered in a PIPE transaction, questioning the appropriateness to use a resale registration statement (rather than a primary registration statement) for those shares, especially for PIPE transactions involving convertible securities.

In these cases, the SEC will use the factors it outlined in its 1997 interpretative guidance and evaluate the facts and circumstances of the issuance and the resale registration statement by assessing (i) the amount of securities involved, (ii) how long the securities have been held, (iii) whether the investors are at market risk from the time they purchase the securities, (iv) the circumstances under which the securities were acquired and (v) whether it appears the seller is acting as a conduit for the issuer. If the SEC finds that the private placement was properly completed, the issuer can proceed with the use of the resale registration statement. If the SEC disallows the resale registration statement to proceed, the issuer can cut back on the number of shares and then file a second resale registration statement for the shares that were cut back.

Transactions Not to be Confused with PIPE Transactions

The following transactions are not to be confused with PIPE transactions:

- **Death spiral or toxic convert** "Death spiral" or "toxic convert" refers to a privately placed convertible security that has a floating conversion ratio but without a floor. The conversion ratio of the security adjusts based upon the market price of the issuer's securities at some point in the future, usually at the time of conversion. Death spirals or toxic converts typically reset or adjust downward (to protect the investor) and not upward (to protect the company). Death spirals or toxic converts typically are priced at some discount to the company's closing bid price over a period of days preceding the pricing date. This price can be manipulated easily.
- **Equity line of credit** Under an equity line of credit, the issuer enters into a purchase agreement with an investor pursuant to which the company has the right, during the term of the equity line and subject to certain conditions, to put its securities to the investor. Some equity lines of credit are completed using a shelf registration statement and others are completed as private placements with an obligation to register the resale of the securities sold under the equity line. Unlike PIPEs, these transactions can also result in ongoing and substantial dilution.
- **Registered direct transaction** A registered direct offering is a public offering but some of its features are akin to a private placement (i.e., sales to selected institutional investors by a placement agent). The offered securities in a registered direct transaction are sold pursuant to an effective registration statement. Investors receive a preliminary prospectus (or red herring) during the marketing phase and a final prospectus prior to closing. The offering closes through DTC and investors receive their shares through DTC rather than receiving physical certificates like they would in a PIPE transaction.

Private Investment in Public Equity ("PIPE") Transactions

Checklist of Key Questions

- Are the issuer's Exchange Act filings current?
- What information will be shared with investors other than the mere fact that the issuer is considering a financing through a PIPE transaction?
- When will such information be cleansed, or will investors remain restricted from trading for a period of time?
- Will the issuer use any information other than its Exchange Act filings?
- Does the placement agent have appropriate information walls and training in place for personnel participating in PIPE transactions?
- Does the placement agent use a wall crossing script or an NDA?
- Will the transaction be structured as an at-market deal?
- What securities will be offered in the PIPE transaction? If there are warrants or convertible securities, have the parties considered the securities exchange rules?
- Has the issuer and its counsel had a discussion with the securities exchange?
- Has the issuer considered the time required to file a resale registration statement? Any concerns regarding a review by the SEC?
- Are there any concerns regarding the amount of securities that will be included in the resale registration statement?
- Has the issuer filed its supplemental listing application?
- Does the purchase agreement provide for any covenants that limit the company's activities?

Registered Direct Offerings ("RDOs")

Here's the deal:

- RDOs are hybrid securities offerings, meaning that these offerings have some characteristics typically associated with private placements and some characteristics of public offerings.
- An RDO is a public offering usually made pursuant to an issuer's effective registration statement wherein a financial intermediary acts as a placement agent on a best efforts basis and identifies investors that purchase the registered securities from the issuer.
- RDOs are generally marketed and sold to a limited number of institutional investors, however, given that an RDO is a public offering, securities can also be sold to retail investors.

What's the Deal?

A registered direct offering, or RDO, is a public offering of securities that is sold on a best efforts basis (rather than on a firm commitment basis) by a placement agent that is engaged by the issuer to introduce the issuer to potential purchasers. The purchasers buy the securities directly from the issuer.

An RDO is generally marketed on a wall-crossed or confidential basis, usually to a select number of accredited and institutional investors. Given that an RDO is a public offering, securities may be offered and sold to retail investors. An issuer may find an RDO an attractive financing option if the issuer would like to test the market or conduct an offering without attracting much market attention but would rather not incur the liquidity discount often associated with a private placement, or PIPE, transaction. Given that an RDO is marketed to a limited number of investors, it may be less disruptive to the trading market for the issuer's securities than a fully marketed follow-on offering. Also, from time to time, an RDO may be used to issue and sell securities to one or to a handful of investors, which may include existing securityholders that may not be able to acquire restricted securities.

Structuring Alternatives

An RDO may be structured as (1) an *"any-or-all"* transaction, where the transaction will proceed to a closing regardless of the amount raised in the offering, (2) a *"minimum-maximum"* transaction, where a certain minimum amount of proceeds must be raised in order for the transaction to close and a maximum offering size also is indicated, or (3) an *"all-or-none"* transaction, where all of the securities offered must be sold in order for the transaction to close.

If an RDO is structured as a minimum-maximum offering or as an all-or-none offering (not an any-or-all offering), the placement agent must set up an escrow account at a national bank in order to collect and hold the investor funds until the conditions for release are met pursuant to Rule 15c2-4 under the Securities Exchange Act of 1934 (the "Exchange Act").

Participants in an RDO

Companies that are reporting companies, and that have an effective shelf registration statement, may consider an RDO.

Generally, the issuer will retain a financial intermediary to act as the placement agent. The placement agent will act on a best efforts only basis. The placement agent will introduce the issuer to potential investors; however, the placement agent has no obligation to purchase any of the offered securities. Unlike a firm commitment underwritten offering, in which the underwriter purchases the securities and resells these to investors, in an RDO, the investors are purchasing directly from the issuer.

Generally, the placement agent will "wall cross" potential investors in order to gauge their interest in a transaction.

An issuer may conduct a registered direct offering without a placement agent; however, this is generally only the case when the investor or investors are existing security holders or when the investors have approached the issuer directly (as a reverse inquiry) and expressed an interest in purchasing securities.

As noted above, to the extent that the RDO is subject to a contingency, and an escrow agent is required, the issuer and the placement agent will retain an escrow agent that is a national bank, which will establish an escrow account to hold investor funds.

Documentation

Generally, the issuer and the placement agent will enter into an engagement letter pursuant to which the issuer will retain the placement agent to act on an exclusive basis as its agent in connection with the proposed RDO. The letter will specify the placement agent's fee, which may include a percentage of the amount raised, as well as warrants. The engagement letter may also address expense reimbursements, tail provisions, and other matters. Finally, the issuer will agree to indemnify the placement agent for losses arising in connection with certain matters.

At pricing, the issuer and the placement agent will enter into a placement agency agreement. The placement agency agreement will supersede the engagement letter. The placement agency agreement will contain provisions that are very similar to those that would be contained in an underwriting agreement. The issuer will make representations and warranties about the issuer and its business, make certain covenants pertaining to the offering, and indemnify the placement agent and certain of its affiliates from liabilities under the Securities Act of 1933 that may arise in connection with the offering.

Despite the fact that a registered direct offering is conducted on a best efforts, and not a firm commitment, basis, the placement agent nonetheless would be considered a statutory underwriter. As a result, the placement agent and its counsel would conduct a diligence review in connection with the proposed offering. In addition, and in order to bolster the placement agent's diligence defense, the placement agent would generally require as a condition to closing, and set out in the placement agency agreement, the delivery of a legal opinion by the issuer's counsel, as well as the delivery of a 10b-5 negative assurance letter, and a comfort letter in customary form delivered to the placement agent by the issuer's independent accountants. Of course, depending on the particular issuer and its industry, additional deliverables may be required. Often, in order for the issuer's accountants to deliver a comfort letter, given that the placement agent is acting only on a best efforts basis, the placement agent may be required to deliver a representation letter. The representation letter to the accountants would state that the placement agent will conduct diligence that is consistent with the diligence that would be undertaken in connection with a firm commitment registered offering.

From time to time, institutional investors that are participating in an RDO will express an interest in having a separate subscription or purchase agreement between the investor and the issuer pursuant to which the issuer makes representations and warranties directly to the investor. This should be considered carefully. A definitive commitment to purchase cannot be entered into until pricing information has been made available and time of sale materials have been made available.

Offering Materials

Investors may receive offering materials, such as a free writing prospectus, preliminary prospectus or preliminary prospectus supplement. Often, an issuer and placement agent may use a preliminary prospectus or preliminary prospectus supplement but may defer filing it until closer to the filing deadline while the issuer and placement agent are discussing the potential offering with wall-crossed investors.

Certain issuers, such as master limited partnerships, may not use a free writing prospectus in connection with an agency public offering.

Securities Offered in an RDO

An RDO may be used to offer and sell any security—common stock, preferred stock, or debt securities. An issuer may sell its own newly issued shares. A selling stockholder also may also use an RDO to sell its shares, either alone or with primary (issuer) shares.

The Registration Statement

For purposes of conducting an RDO, an issuer may file a "bullet" registration statement or rely on a shelf takedown.

- **Bullet registration statement** An issuer that does not have an effective shelf registration statement must file either (1) a single purpose registration statement for the express purpose of conducting an RDO (a "bullet") or (2) a shelf registration statement. Once the Securities and Exchange Commission clears the registration statement, the issuer and the placement agent agree to conduct a registered direct offering and enter into a placement agency agreement. The issuer prepares and files a prospectus (or prospectus supplement) that describes the offering, and investors purchase the securities directly from the issuer.
- **Shelf takedown** If the issuer has an already existing and effective shelf registration statement, it may choose to conduct a takedown pursuant to its shelf registration statement (a "shelf takedown").

Depending how the offering is marketed and sold, the issuer will prepare a preliminary prospectus supplement or a final prospectus supplement that describes the offering. The issuer and the placement agent also will enter into a placement agency agreement.

Is an RDO a distribution?

A placement agent will sell the securities on a best efforts basis, and in doing so, can only engage in passive market making activities and cannot engage in market stabilizing transactions. Since an RDO is a best efforts agency deal, RDOs do not include an over-allotment option which relates principally to stabilizing in connection with a firm commitment offering. Nonetheless, an issuer may increase the offering size to meet any additional demand.

An RDO will usually constitute a "distribution" for purposes of Regulation M, given that the placement agent will use special selling efforts, and the amount of securities offered will often be significant.

As a result, the placement agent is subject to the trading restrictions of Regulation M, and should be aware of the applicable restricted period for the issuer's securities and submit the required Regulation M filings with the Financial Industry Regulatory Authority.

For investors, it is important to note that Rule 105 of Regulation M would not apply since the offering is conducted on an agency basis.

Securities exchange rules and RDOs

An issuer considering an RDO should take into account the applicability of the rules of the securities exchange. Although an RDO is a public offering, it likely would not be considered a broadly distributed or "public offering" for purposes of the applicable securities exchange. To the extent that the RDO will result in an issuance of voting stock in excess of 20% of the issuer's pre-transaction total shares outstanding, and the offering is being completed at a discount to the market price, the transaction may require shareholder approval. In evaluating whether an RDO is a public offering for purposes of these rules, the securities exchanges will consider several factors, including, but not limited to, whether the offering is an underwritten (a firm commitment) offering, the nature of the marketing process, the number of offerees, and the degree of investor control of the terms. In addressing this concern, an issuer may choose to limit the offering size and decide to offer shares of common stock and warrants in an "at market" offering (not at a discount).

Comparing an RDO with a PIPE transaction

An RDO is a public offering but some of its features are akin to those of a private investment in public equity ("PIPE") transaction. Since the placement agent may market a potential RDO as it would market a PIPE transaction (that is, by obtaining confidentiality undertakings until such time as an actual transaction is announced), RDOs are often (though mistakenly) referred to as "registered PIPEs." The following table provides some comparisons.

Differences	Registered Direct Offering	PIPE Transaction
Type of securities offering	Hybrid. Offering methodology has certain characteristics associated with a public offering and a private placement.	Private.
Typical investors	Any targeted investors, but commonly the institutional accredited investors and qualified institutional buyers ("QIBs").	Institutional accredited investors and QIBs.
Usual marketing material	Investors receive a preliminary prospectus (or preliminary prospectus supplement) during the marketing phase and a final prospectus or prospectus supplement prior to closing.	Investors may receive a private placement memorandum or rely on the issuer's public filings.
Purchase agreement between the issuer and each investor	Generally not needed.	Yes. Investors enter into a purchase agreement that irrevocably commits them to purchase a fixed number of securities at a fixed price.
Offering price affected by liquidity discount	No.	Yes.
Mode of settlement	Through the Depository Trust Company ("DTC") system. Usually closes on a T+2 or T+3 basis.	Outside of the DTC system. Investors receive physical certificates.
When offered, securities may be transferred	Freely transferable.	Restricted securities, which may be resold in other exempt transactions, or pursuant to an effective resale registration statement when available.

Registered Direct Offerings ("RDOs")

Checklist of Key Questions

- Are the issuer's Exchange Act filings current? What materials will be used to market the potential offering?
- Does the issuer's board of directors and pricing committee understand the RDO structure?
- Does the placement agent use a wall-crossing script or a non-disclosure agreement in order to approach potential investors?
- Is an escrow account needed based on the structure of the RDO?
- Have the parties considered the applicability of the securities exchange rules in the context of certain offerings in which more than 20% of the pre-transaction total shares outstanding will be sold at a discount?
- If there is no placement agent, has the issuer made arrangements for DTC settlement through the issuer's transfer agent?

Here's the deal:

- A rights offering provides a company's stockholders an opportunity to subscribe for additional shares, based on the number of shares they own as of a set record date.
- Rights offerings typically remain open for a set period, which is usually a couple weeks.
- A rights offering does not require stockholder approval, provided that the rights offering is not a "standby" rights offering, wherein the standby purchaser receives special rights or preferences.
- A majority of rights offerings involve non-transferable rights, although an issuer can also elect to structure an offering to permit rights to be transferable.
- Trading of the transferable rights can take place either on the securities exchange where the issuer's common stock is listed or over the counter, if the common stock is not listed on a securities exchange.

Introduction

In the midst of the economic downturn driven by the COVID-19 pandemic, companies facing liquidity issues may consider a rights offering. This guide provides an overview of rights offerings.

What's the Deal?

A rights offering typically provides an issuer's existing shareholders the opportunity to purchase a *pro rata* portion of additional shares (also referred to as "subscription warrants") of the issuer's stock at a specific price per share (the "subscription price"), which may be set at a discount to the recent trading price of the issuer's stock.

In a rights offering, all shareholders are given the right to purchase shares based on the number of shares they own on a specified record date, so there is no dilutive effect to shareholders who exercise the rights issued to them. Because there is no dilutive effect, stock exchange rules generally do not require issuers to obtain shareholder approval for issuances that may involve 20% or more of the outstanding shares at a discount to current market value.

Typically, a rights offering will be open for a period of a couple weeks. There are no federal securities laws requiring the rights offering to be open for a specified period of time.

Types of Rights Offerings

Standby Rights Offering

In a standby rights offering, a third party (usually an underwriting syndicate, an investment bank, an affiliate of the investment bank or an affiliate of the issuer that may not be a registered broker-dealer) agrees, prior to the commencement of the rights offering, to purchase any shares or rights that are not subscribed for in the rights offering. This arrangement is commonly known as a "standby commitment," and provides the issuer with some assurance that it will raise the necessary capital. If the rights offering is structured as a standby rights offering, the issuer will enter into an agreement with the party agreeing to provide the standby commitment. An issuer may also consider a standby rights offering if the issuer's stock price is volatile. This is because the offering period is usually at least 16 days but can extend up to 60 days. Most shareholders will wait until the end of the subscription period to decide whether to exercise their rights. If the shares are trading in the market for the same or less than the subscription price, then shareholders will not exercise their rights. The issuer has to consider where to set its subscription price to avoid this, while not selling the shares at too steep of a discount price. Entering into a standby commitment may help mitigate this issue.

- **Fees associated with a standby commitment** As compensation for shifting the risk from the issuer if there is an under-subscription, the standby commitment party is paid a flat standby fee, plus a per share amount for each unsubscribed share purchased by it after the subscription offer expires and for each share purchased by it on the exercise of rights purchased in the secondary market, if the rights are transferable.
- **Requirements for standby commitment parties** There is no broker-dealer licensing requirement for standby commitment parties, although most are investment banks or an underwriting syndicate formed by an investment bank. However, one or more substantial investors will sometimes agree to act as a standby commitment party.

Direct Rights Offering

In a direct rights offering, there is no standby commitment party, or standby purchaser. Instead, the issuer only sells the number of shares evidenced by the exercised rights. A direct rights offering is cheaper than a standby rights offering because there are no fees associated with providing the standby commitment. However, a poorly subscribed direct rights offering may leave an issuer under-capitalized.

Preparation and Considerations in Connection with a Rights Offering

A rights offering requires advance planning and preparation. The issuer must take a number of actions within a certain time frame, including, but not limited to, the following: providing information to shareholders; marketing the rights offering to shareholders; collecting exercise certificates and payment from shareholders; and filing documentation with the SEC and the applicable stock exchange.

More specifically, the issuer must determine if it has sufficient authorized and unissued shares to accommodate the number of shares that could be issued in connection with the rights offering. If not, the necessary corporate actions must be taken to authorize new shares. The issuer's board of directors will be required to: (1) authorize the rights offering; (2) set the record date to determine the shareholders of record entitled to participate in the rights offering; (3) set an offer date; and (4) set an expiration date for the offer period.

If other events or activities, which require a record date, are approaching, such as a record date for an annual shareholders meeting, or dividend distribution, the issuer must also ensure that there are no conflicting shareholders of record for two different events or activities occurring around the same time period. Once the record date is set for the rights offering, no other record date for any other purpose should be set by the issuer for at least 7 business days after the expiration of the offering period.

Additional Considerations for a Standby Rights Offering

If an issuer chooses to conduct a standby rights offering, it will have to consider who will act as the standby commitment party, often referred to as the "standby purchaser," and the amount of the commitment, which will be based on the issuer's financing needs. Additionally, in a standby rights offering, the issuer may want to put a cap on the number of shares that the standby commitment party may acquire in order to avoid an inadvertent change of control. Furthermore, in a standby offering that involves transferable rights, a market may develop for the rights that may create arbitrage opportunities (between the issuer's common stock and the rights) or price volatility in the issuer's common stock.

Participants in Rights Offerings

Unless the issuer is a large corporation or has a highly concentrated shareholder base, it will most likely seek assistance from third-party participants. Depending on the size of the issuer and the type of rights offering, the issuer may engage a dealer-manager, a subscription agent, and/or an information agent. The issuer also may engage an investment bank (underwriter) to act as the standby purchaser. The role of each party is presented in some detail below:

The role of the deal-manager. Usually a dealer-manager is hired to market the rights offering and solicit the exercise of rights and participation in the over-subscription privilege, if any. In a non-transferable rights offering, issuers may opt to avoid marketing expenses and sales commissions by doing this themselves.

The role of the subscription agent. Usually, a subscription agent is hired to send a prospectus or prospectus supplement, as the case may be, and to collect all of the completed subscription certificates and related payments from the shareholders. This role may be filled by an issuer's transfer agent.

The role of an information agent. Usually, an information agent is hired to answer any shareholder questions and provide further information about the rights offering. If the issuer has an adequately staffed investor relations department, a third party may not be required for this task.

Rights Offerings for Business Development Companies

Business development companies ("BDCs") are closed-end funds that are regulated by the Investment Company Act of 1940, as amended (the "1940 Act"). Under regulatory constraints imposed by the 1940

Act, BDCs cannot issue shares of its common stock and sell them at a price below its net asset value ("NAV") without first obtaining shareholder approval. However, if a BDC hopes to sell shares below the NAV, without shareholder approval, the BDC may do so through a rights offerings to its existing shareholders.

A BDC will typically complete a rights offering in two phases: the primary subscription period and the oversubscription period. In the first phase, shareholders are given the exclusive opportunity to purchase additional shares from the BDC, on a pro-rata basis. In the second phase, shareholders that have fully participated in the primary subscription period will be permitted to purchase additional shares as part of the oversubscription period. Rights offerings for BDCs can be transferable or non-transferable. In the case that a BDC rights offerings is transferable, shareholders will be allowed to sell those rights in the open market. The SEC's position, has generally been, that for every three shares of common stock currently outstanding, no more than one additional share of common stock can be issued in a transferable rights offering, below the NAV. In non-transferable rights offerings, however, BDCs will not be subject to these restrictions, since the anti-dilution concern is diminished.

Regulatory Requirements for Rights Offerings

Because the rights are granted to existing shareholders for no consideration, the rights do not need to be registered with the SEC; however, the issuer must register the shares that will be allocated to the shareholders who elect to participate in the rights offering. In certain circumstances, rights may need to be registered. In a transferable rights offering, if a controlling shareholder chooses to trade rights rather than exercise them, the requisite number of rights would need to be registered and a statement would need to be included in the prospectus stating that the prospectus may be used to cover the sales of rights by such controlling shareholder. The issuer must file a registration statement on Form S-1 or Form S-3, if eligible or, if an issuer has an effective existing shelf registration statement, the issuer can review it to determine if it covers the offer of rights.

Regulation M covers market manipulation during rights offerings. Therefore, if a rights offering involves a distribution as defined in Rule 100, the applicable restricted period of Rules 101 and 102 applies to bids for or purchases of the security being distributed and any reference security. Transactions involving the rights themselves are not subject to Rule 101 or 102. However, Rule 104 applies to stabilization transactions in any security, including the rights.

Stock Exchange Requirements for Rights Offerings

The New York Stock Exchange ("NYSE") and Nasdaq Stock Market ("Nasdaq") have similar requirements for rights offerings, although summarized briefly below, these requirements require a closer look:

- **NYSE Rule 703.03(B)** Nasdaq Rules 5250(b)(l). The NYSE requires all known terms and details of a proposed rights offering to be publicly released immediately after the issuer's board of directors has taken action. Nasdaq requires the issuer to promptly disclose any material information that would reasonably be expected to affect the value of its securities.

- **NYSE Rule 703.03(B)** Nasdaq Rules 5250 (e)(6). The exchanges require at least ten days' advance notice of any record date fixed in connection with an offering of listed securities to shareholders.
- **NYSE Rule 703.03(C)** The NYSE requires issuers to send written notice to shareholders at least ten days in advance of the proposed record date. The notice should state that the issuer intends to make a rights offering. The notice should also include to the extent finally determined: (1) the title of the security to be offered; (2) the proposed subscription ratio; (3) the proposed subscription price; (4) the proposed record date for determination of those entitled to subscribe; (5) the proposed expiration date of the right to subscribe; and (6) the expected date on which the subscription certificates will be mailed.
- **NYSE Rule 703.03(E)** The NYSE requires that shareholders of listed securities be allowed at least 16 days after the rights have been mailed to subscribe to the offering, although it could be reduced to fourteen days if certain mailing conditions are met. Further, it is recommended that subscription certificates be issued to stockholders as soon as practicable after the record date.
- **NYSE Rule 703.03(M)** The NYSE requires that the issuer notify it by telephone immediately upon receiving notice that the registration of the offered securities has become effective.
- **NYSE Rule 703.03(N)** It is highly recommended that the issuer list rights, if they are transferable, in addition to listing the new shares on the exchange.
- **NYSE Rule 703.03(A)** It is recommended that the issuer confer with its exchange representative well in advance of the offering date to ensure coordination of actions and arrangement of a time schedule.
- **NYSE Rule 703.03(D)** It is recommended that (1) the effective date be set for at least 6 business days in advance of the record date in order to prevent confusion if there is a delay in the effectiveness of the registration statement, unless the issuer already has an effective shelf registration statement and (2) the issuer's board of directors establish the record date as a specified date "or such later date as registration under the Securities Act of 1933 shall become effective." It is required that once the record date is set for the rights offering, no other record date for any other purpose should be set by the issuer between the record date for the subscription offering through at least 7 business days after the expiration of the offering period.

Comparing a Rights Offering with a PIPE Transaction

With public companies, a rights offering is a form of public offering that may have comparable characteristics to private investment in public equity ("PIPE") transactions. Rights offerings offer a number of advantages compared to PIPE transactions. For example, rights offerings typically have no shareholder approval requirements. Therefore, rights offerings can be completed more quickly than other forms of financing and can be a cheaper source of pre-filing and post-filing capital raising for issuers contemplating, or emerging from, chapter 11 bankruptcies.

Additional comparisons between rights offerings and PIPE transactions are offered below.

Differences	Rights Offerings	PIPE Transaction
Stockholder approval	No. Even if the rights offering results in an issuance of common stock representing 20% or more of the voting power outstanding before the issuance unless there is a standby purchaser.	Yes. If more than 20% of the pre-transaction total outstanding shares are being issued at a discount or if the transaction represents a change of control.
Usual marketing materials	Less marketing required, since the offering is made to existing shareholders. The issuer must file a prospectus or prospectus supplement, as the case may be, with the SEC.	Investors will typically rely on the issuer's public filings.
Purchase agreement between the issuer and each investor	Not required. There will be a standby agreement in transactions involving a standby purchaser.	Yes. Purchase agreements are entered into by investors, committing them to purchase a fixed number of shares at a fixed price.
When offered, securities may be transferred	A majority involve non-transferable rights.	Securities are restricted, may be resold in other exempt transactions or pursuant to an effective resale registration statement.

Checklist of Key Questions

- Has the issuer made a decision as to whether it will use a direct rights offering or a standby rights offering?
- Does the issuer have enough authorized and unissued shares to accommodate the number of shares that will be issued in connection with the rights offering?
- Will the rights be transferable?
- Will there be a standby purchaser, and who will act as a standby purchaser?
- How will the standby purchaser be compensated?
- If there is a standby purchaser, will the securities exchange rules require shareholder approval to be obtained?
- Will the issuer retain a dealer-manager or other third parties?
- Is the rights offering being undertaken in the context of a distressed issuer that may need to provide additional disclosures?

Here's the deal:

- Rule 10b-18 provides a non-exclusive safe harbor for an issuer from liability under certain market manipulation rules and Rule 10b-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in connection with stock repurchases.
- This safe harbor is available for repurchases of an issuer's securities on any given day. To fall within the safe harbor, the issuer's repurchases must satisfy, daily, each of the rule's manner, timing, price and volume conditions. Failure to meet any one of these conditions disqualify all of the issuer's repurchases from the safe harbor for that day.
- Due to the increased scrutiny surrounding stock repurchase programs, issuers seeking to repurchase their common stock should have a heightened awareness of the regulatory, legal and other considerations discussed here.

What's the Deal?

Rule 10b-18 provides an issuer (and its "affiliated purchasers") with a non-exclusive safe harbor from liability under certain market manipulation rules (i.e., Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act) when repurchases of the issuer's common stock are made in accordance with the rule's manner, timing, price and volume conditions. The safe harbor is available for purchases of the issuer's stock on any given day. To come within the safe harbor, the issuer's repurchases must satisfy, daily, each of the rule's four conditions. Failure to meet any of the four conditions will disqualify all of the issuer's repurchases from the safe harbor for that day.

Purpose and Benefits of a Stock Repurchase Program

An issuer may want to engage in stock repurchases for a variety of reasons, including to send a signal to the market that the stock is undervalued and a good investment, and to reduce its cost of capital.

There are several potential benefits associated with stock repurchase programs depending on the issuer's circumstances. These may include the following:

- The availability of a non-exclusive safe harbor from liability for manipulation of the issuer's stock price (if Rule 10b-18's conditions are met);
- Greater certainty to the issuer and affiliated purchasers in planning purchases of the issuer's common stock;
- Increased liquidity, which should benefit shareholders;

- Minimizing dilution following a stock acquisition;
- A tax efficient alternative to dividends as a way to return money to shareholders; and
- Shares repurchased by an issuer are either canceled or kept as treasury stock, which then reduces the number of the issuer's shares outstanding, which may be beneficial to the issuer's earnings per share calculations.

Conditions for Repurchases under Rule 10b-18

Rule 10b-18's non-exclusive safe harbor is available only when the repurchases of the issuer's common stock in the market are made in accordance with the following conditions:

- Manner of purchase condition: requires an issuer to use a single broker or dealer per day to bid for or purchase its common stock;
- Timing condition: restricts the periods during which an issuer may bid for or purchase its common stock;
- Price condition: specifies the highest price an issuer may bid or pay for its common stock; and
- Volume condition: limits the amount of common stock an issuer may repurchase in the market in a single day.

Failure to meet any one of the rule's conditions will disqualify the issuer's purchases for that day from the safe harbor.

Manner of Purchase Condition

On a single day, the purchases and any bids of the issuer or its affiliated purchasers must be made through one broker or dealer. However, this restriction does not bar the issuer or its affiliated purchasers from making purchases if they are deemed not solicited by or on behalf of the issuer, such as purchases not solicited from additional brokers or dealers or when a shareholder approaches the issuer to have it buy shares. An issuer must evaluate whether a transaction is "solicited" based on the facts and circumstances in each case. Additionally, on a daily basis, the issuer may use a different broker or dealer to execute purchases. Furthermore, an issuer may use a different broker or dealer during an after-hours trading session from the one used during regular hours.

An issuer that directly accesses an electronic communication network ("ECN") or an alternative trading system ("ATS") to purchase common stock will be considered to be using one broker or dealer and cannot purchase its common stock through a non-ECN or non-ATS broker or dealer on the same day.

The purpose of this condition is to avoid creating the false appearance of widespread purchasing interest and trading activity in the issuer's common stock through the use of many brokers or dealers on any given trading day.

Timing Condition

A purchase by the issuer may not be the opening transaction reported in the consolidated system, the principal market or the market where the purchase is affected. A consolidated system is a transaction or quotation reporting system that collects and publicly disseminates on a current and continuous basis, transaction or quotation information in common equity securities pursuant to an effective transaction reporting plan or an effective national market system plan.

Additionally, the purchase may also not be effected during the ten minutes before the scheduled close of the primary trading session in the principal market for the security or during the last ten minutes before the scheduled close of the primary trading session in the market where the purchase is effected for a security that has an average daily trading volume ("ADTV") of $1 million or more, and a public float of $150 million or more. The ADTV is the volume reported for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected. For all other securities, purchases may not be effected during the 30 minutes before the scheduled close of the primary trading session in the principal market for the security or the 30 minutes before the scheduled close of the primary trading session in the market where the purchase is affected.

An issuer purchase may be effected following the close of the primary trading session in the principal market until the termination of the period in which the last sale prices are reported in the consolidated system if: (i) the purchase is effected at a price that does not exceed the lower of the closing price of the primary trading session in the principal market for the security, and any lower bids or sales prices subsequently reported in the consolidated system; (ii) all of the other Rule 10b-18 requirements are met; and (iii) the issuer's Rule 10b-18 purchase is not the opening transaction of the session following the close of the primary trading session.

The purpose of this condition is to prevent the issuer from establishing the opening or closing price of the stock, both of which are considered to guide the direction of trading.

Price Condition

During trading hours, if the security is reported in the consolidated system, displayed and disseminated on any national securities exchange, or quoted on any inter-dealer quotation system that displays at least two price quotations, issuer purchases must be made at a price not exceeding the highest independent bid or last transaction price, whichever is higher. For all other securities, an issuer will need to look at the highest independent bid obtained from three independent dealers.

For after-hours trading, stock repurchase prices must not exceed the lower of the closing price of the primary trading session in the principal market for the security and any lower bids or sales prices subsequently reported in the consolidated system by other markets. The issuer is permitted to repurchase until the termination of the period in which last sale prices are reported in the consolidated system.

The purpose of the price condition is to prevent an issuer from propping up its stock price through the repurchases, or from supporting the price at a level that would not otherwise be maintained by independent market forces.

Volume Condition

The purchases on a particular day may not exceed 25% of the ADTV in the preceding four weeks. "Block" transactions are included in determining the 25% limit and include trades of not less than $50,000 with a volume of not less than 5,000 shares if the trade value is less than $200,000, but excludes any securities the issuer knows or has reason to know were accumulated by a broker-dealer, acting as a principal, for the purpose of resale to the issuer. Alternatively, the issuer may make one "block" purchase per week and not be subject to the 25% limit, provided the "block" purchase is the only Rule 10b-18 purchase made on that same day. Rule 10b-18's volume calculation carries over from the regular trading session to after-hours trading sessions.

The purpose of the volume condition is to prevent the issuer from dominating the market by purchasing a large amount of its common stock relative to other market transactions.

Severe Market Downturns

The Rule 10b-18 safe harbor conditions are modified following a market-wide trading suspension. The volume condition is modified so that the issuer may purchase up to 100% of the security's ADTV. Additionally, the time of purchase condition does not apply (a) from the reopening of trading until the scheduled close of trading on the day that the market-wide trading suspension is imposed or (b) at the opening of trading on the next trading day until the scheduled close of the trading day, if a market-wide trading suspension was in effect at the close of trading on the preceding day.

Establishing a Stock Repurchase Program

When establishing a stock repurchase program an issuer should consider (i) the impact on the issuer's cash position and capital needs for its continuing operations; (ii) alternative uses for the cash that will be used for repurchases, including repayment of outstanding indebtedness; and (iii) the possible effect on earnings per share and book value per share. The issuer should consult with its accountants regarding the issuer's capital position prior to implementing a stock repurchase program. Additionally, prior to implementing a stock repurchase program, the issuer should conduct a review of its charter, bylaws and the agreements to which it is a party, or by which it is bound, to determine whether there are any restrictions on, or impediments to, the issuer's use of funds to acquire its own securities. Specifically, the issuer's loan agreements and security documents should be reviewed for any such limitations. These restrictions may be direct limitations on repurchases or indirect limitations in the form of financial ratios and covenants.

State Law Restrictions

Certain provisions of the Delaware General Corporation Law ("DGCL") contain restrictions regarding legally available funds that apply to repurchases of shares of capital stock. Under DGCL Section 160, a Delaware corporation cannot purchase shares of its capital stock when the purchase "would cause any impairment of the capital of the corporation." The issuer should consult with its outside counsel regarding any applicable state law restrictions prior to implementing a stock repurchase program.

Additionally, the California Corporations Code requires that a California corporation must follow certain requirements prior to engaging in a distribution which includes issuer repurchases. Accordingly, an issuer repurchase may only be made if either: (a) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (i) the amount of the proposed distribution plus (ii) the preferential dividends arrears amount, or (b) immediately after the distribution, the value of the corporation's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount.

Board Approval

Any stock repurchase program should be authorized and approved by the issuer's board of directors. As part of this authorization, the board should document the purpose of the share repurchase. It is important that the board concludes that the repurchase program is desirable and in the issuer's and its shareholders' best interests. When approving a repurchase program, it is advisable that the board establishes a record of discharging its fiduciary duty. The record should include a current review, in consultation with the issuer's accountants, of the issuer's capital position and a thorough discussion of the purpose of the program.

Reporting Requirements

Regulation S-K and Forms 10-Q, 10-K and 20-F (for foreign private issuers) require periodic disclosure for all issuer repurchases of equity securities. This disclosure is required regardless of whether the repurchase is effected in reliance on the Rule 10b-18 safe harbor. An issuer must disclose in tabular form (a) the total number of shares, by month, repurchased during the past quarter; (b) the average price paid per share; (c) the number of shares that were purchased as part of a publicly announced repurchase plan; and (d) the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs. For publicly announced repurchase plans, the issuer is also required to disclose (by footnotes to the table) the following information: (a) the announcement date; (b) the share or dollar amount approved; (c) the expiration date (if any) of the plans or programs; (d) each plan or program that has expired during the period covered by the table; and (e) each plan or program that the issuer has determined to terminate prior to expiration or under which the issuer does not intend to make further purchases. Additionally, the issuer should consider discussing any repurchase program under the "Liquidity and Capital Resources" section of the MD&A if material. The issuer should also consider whether disclosure of significant repurchases is required in the notes to its financial statements.

Public Announcements

Issuers should publicly announce the adoption of a stock repurchase program before it is implemented. However, an announcement should not be made unless the issuer actually intends to repurchase shares because any termination of the repurchase program without purchases could be deemed manipulative in the absence of a sound business reason.

The specifics of the public announcement depend on the circumstances, but the issuer should include the following:

- The reason for the repurchase;
- The approximate maximum number or aggregate dollar amount of shares to be repurchased;
- The method of purchase to be used;
- Any significant corporate developments which have not been previously disclosed;
- The impact of the repurchase program on the remaining outstanding shares;
- Any arrangement, contractual or otherwise, with any person for the purchase of the shares;
- Whether the purchases are to be made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases upon the market for the shares; and
- The duration of the program.

The announcement of the stock repurchase program should be made on Form 8-K with any press release included as an exhibit for purposes of Regulation FD. The issuer should also be mindful that any material changes to its stock repurchase program (including program size) should be publicly disclosed as well.

Repurchase Structures

Issuers have significant flexibility with respect to choosing a particular repurchase structure ranging from open market repurchases to repurchases that are subject to tender offer rules. An issuer may structure its repurchase as an accelerated stock repurchase ("ASR"). An ASR may result in faster execution and more price certainty; however, ASR repurchases do not benefit from the Rule 10b-18 safe harbor. An ASR is a privately negotiated transaction, usually documented as a forward contract, in which a repurchase agent agrees to sell a predefined amount of stock to an issuer at a price per share based on the volume weighted average price during the specified period. A repurchase agent acts as the seller of the issuer's shares in an ASR and the issuer acts as the purchaser buying back its own shares. ASRs provide numerous benefits, including transaction efficiency, an immediate share count reduction, certainty as to the timing and quantity of the repurchase, and possible accounting advantages. Notwithstanding these benefits, ASRs have been the subject of some criticisms. As a result, an issuer should consider its alternatives carefully.

At the beginning of the ASR, the issuer pays a predefined dollar amount to the repurchase agent for a specified number of securities. The repurchase agent generally borrows securities from stock lenders and delivers those securities to the issuer. Over time, the repurchase agent will buy securities in the market to cover its borrow and has the option to complete the ASR at any time within a pre-agreed period. The purchase period will have a fixed starting and end point, though the repurchase agent will have the right, upon notice to the issuer, to shorten the period. An average price is determined for the purchase period, which is typically based on the Rule 10b-18 pricing condition minus an agreed discount or price adjustment. At the ASR's final settlement, the total number of securities purchased by the issuer generally equals the ASR dollar size divided by the discounted average price. If the repurchase agent did not deliver a sufficient number of securities at inception, it must deliver incremental securities to the issuer at the end of the ASR. Conversely, if the repurchase agent delivered too many securities, the issuer must settle with the repurchase agent in cash or stock on the settlement date.

Purchase Activity Covered by Rule 10b-18

The Rule 10b-18 safe harbor only applies to purchases by an issuer of its common stock (or an equivalent interest, such as a unit of beneficial interest in a trust or limited partnership or a depository share). It does not apply to any other type of security, such as purchases of preferred stock, warrants, convertible debt securities, options or security future products. However, many issuers analogize to the conditions of Rule 10b-18 in connection with repurchases of other equity or equity-linked securities.

Generally, open market purchases by an issuer of its common stock are covered by the safe harbor. However, certain types of purchases of common stock are not covered by Rule 10b-18, due to the greater potential risk of manipulation of the price of the stock by the issuer. Such transactions include: (i) purchases effected by or for an employee plan by an agent independent of the issuer; (ii) purchases of fractional interests; (iii) certain purchases made pursuant to a merger, acquisition or similar transactions involving a recapitalization (subject to certain exceptions); and (iv) purchases made pursuant to a tender offer governed by the Williams Act.

Purchases by an affiliate will be attributable to the issuer under Rule 10b-18 where, directly or indirectly, (a) the affiliate controls the issuer's Rule 10b-18 purchases, (b) the issuer controls the affiliate's Rule 10b-18 purchases or (c) the Rule 10b-18 purchases by the affiliate and the issuer are under common control. Purchases by persons acting in concert with the issuer for the purposes of acquiring the issuer's common stock will also be attributed to the issuer. If Rule 10b-18 purchases are effected by or on behalf of more than one affiliated purchaser (or the issuer and one or more of its affiliates) on a single day, the issuer and all affiliated purchasers must use the same broker or dealer.

Interaction between Rule 10b-18 and Other Federal Securities Laws

Rule 10b-18 provides an issuer a safe harbor from liability for manipulation in connection with stock repurchases in the open market; however, it does not provide protection from other federal securities laws, such as insider trading and antifraud provisions. An issuer making purchases pursuant to a stock repurchase program must still comply with other regulatory reporting requirements.

Rule 10b-5

An issuer can address concerns regarding Rule 10b-5 liability by structuring its stock repurchase program to comply with the Rule 10b5-1 safe harbor. Compliance with the safe harbor under Rule 10b5-1 generally requires that the issuer, before becoming aware of any material non-public information ("MNPI") do one of the following: (i) enter into a binding contract to purchase the securities; (ii) instruct another person to purchase the securities for the issuer's account; or (iii) adopt a written plan for purchasing or selling the securities and conform its stock repurchases to the requirements of a Rule 10b5-1 plan. For a Rule 10b-18 repurchase program to meet the requirements of the safe harbor under Rule 10b5-1, the program must contain one of the following elements: (i) it must specify the amount, price and date of the transactions(s); (ii) it must include a written formula, algorithm or computer program for determining amounts, prices and dates for the transaction(s); or (iii) it must not permit the issuer to exercise any subsequent influence over how, when or whether to make purchases or sales (and any other person exercising such influence under the stock repurchase program must not be aware of MNPI when doing so). Furthermore, the repurchase program must be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1. The issuer must implement reasonable policies and procedures to ensure that individuals making investment decisions on its behalf would not violate the laws prohibiting trading on the basis of MNPI.

The Securities and Exchange Commission ("SEC") recently announced that it settled charges against an issuer relating to its alleged failure to establish reasonable controls to ensure that the issuer did not conduct a buyback while in possession of MNPI. While the issuer named in the SEC's enforcement action had authorization for the stock repurchase from its board of directors, this was given on the condition that the company is not in possession of MNPI. In its press release, the SEC noted that the issuer in question did not take reasonable steps to ensure that its stock repurchase complied with such policy, which highlights the importance of establishing effective checks and policies for issuers using stock repurchase programs.

Regulation M

Under Rule 102 of Regulation M, with certain exceptions, the issuer cannot repurchase its common stock during certain restricted periods if at the same time the issuer or an affiliate is engaged in a "distribution" of the same class of equity securities or securities convertible into the same class of equity securities. Regulation M requires repurchase activity to be discontinued one business day prior to the determination of the offering price for the securities in distribution until the issuer's completion of its participation in distribution. The term "distribution" in this context covers more than conventional public offerings and includes any offering which is distinguished from any ordinary trading transaction by the magnitude of the offering and the presence of special selling efforts and methods. This definition may include certain offerings in connection with acquisitions or exchange offers. Such a distribution might also take place if a major stockholder of the issuer that is an affiliate was engaged in significant sales of the issuer's stock.

An issuer should assume that its officers, directors and controlling shareholders will be deemed to be "insiders;" that the rules as to insiders will apply to purchases as well as sales; that the rules generally require disclosure of material facts concerning the issuer or affecting the market in securities of the issuer not generally known to the public; and that the disclosure or use of non-public information may violate a fiduciary duty owed to the issuer or stockholders to whom it is not disclosed. As a result, an issuer may want to consider:

- Avoiding purchases of stock at any time when an insider is selling equity securities, and insiders should avoid selling the issuer's stock, when the issuer is purchasing its own stock.
- Encouraging its executive officers, directors and other insiders not to go into the market and purchase or sell, on their own behalf, the issuer's common stock during the course of any repurchase

program, unless they advise a designated officer and secure confirmation that such action will not violate any applicable securities or other laws or fiduciary obligations to the issuer or its stockholders.

Negotiating Repurchase Agreements

Repurchase agreements that document traditional open market purchases are typically short form agreements. Most repurchase agents have a form of repurchase agreement that will serve as a starting point. The form repurchase agreement will incorporate the applicable Rule 10b-18 provisions in setting out the mechanics of the repurchase. The repurchase agreement appoints the repurchase agent and authorizes it to make open market purchases on the issuer's behalf in accordance with the terms and conditions set forth in the agreement. As part of the agreement, the repurchase agent agrees to use commercially reasonable efforts to purchase the issuer's outstanding shares and comply with the pricing, timing and volume guidelines that are provided to the repurchase agent by the issuer. The repurchase agent typically disclaims responsibility for complying with Rule 10b-18(b) (4) (volume of purchases) to the extent that the issuer or any affiliated purchaser of the issuer has separately purchased securities without informing the repurchase agent. The agreement will include customary issuer representations and warranties. Unlike the repurchase agreement for traditional open market repurchases, the documentation for ASRs has not become fully standardized. An issuer typically pre-negotiates forms of ASR documents with members of its lending syndicate. Typically, either a master confirmation or agreement is used with supplemental confirmations containing economic terms for individual transactions or stand-alone long-form confirmations that incorporate or reference an ISDA Master Agreement are used. The master confirmation structure is more prevalent as it allows for multiple transactions to be consummated using the same legal terms.

COVID-19 Pandemic

As a result of the COVID-19 pandemic, the US stock markets have experienced heightened volatility. This volatility may generate incentives for issuers to repurchase their common stock at lower prices in comparison to pre-pandemic trading levels. However, these incentives must be balanced in light of the heightened scrutiny surrounding issuer repurchase programs.

One specific regulatory concern relating to the pandemic for issuers contemplating a stock repurchase program is the Coronavirus Economic Stabilization Act of 2020 under the Coronavirus Aid, Relief, and Economic Stability Act (the "CARES Act"), which was enacted on March 27, 2020, to address the impact of the COVID-19 outbreak in the United States. Under the CARES Act, the federal and state governments offer relief and financing programs to assist businesses; however, there are restrictions on stock buybacks during the period in which an issuer obtains a loan or guarantee and for the 12 months after the loan or guarantee is no longer outstanding. A restriction would not be applicable if an issuer already had a contractual obligation to repurchase its shares prior to the enactment of the CARES Act.

Checklist of Key Questions

- Did the issuer take the recommended steps in connection with establishing its stock repurchase program including obtaining the approval of the board of directors?
- Did the issuer consider the structure of the proposed repurchase program? Will the issuer seek authority for repurchases up to a specified dollar amount in an identified period, or for repurchases of a specified number of shares? Or some combination?
- Has the issuer consulted with its auditors and tax advisers?
- Does the issuer intend to rely on the Rule 10b-18 safe harbor? Or will the issuer undertake an ASR? Will either be paired with a Rule 10b5-1 plan?
- Has the issuer and its board established appropriate controls relating to repurchases and communications with the appointed broker?
- Does the issuer have a process in place to address suspensions of repurchases if it were to undertake a securities offering?
- Has the issuer considered how to address any questions that may arise following the announcement of a repurchase program?
- Has the issuer ensured that there is a process in place to report regularly any repurchases?

Here's the deal:

- A Rule 10b5-1 plan is a written securities trading plan that is designed to comply with Rule 10b5-1(c) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").
- Any person or entity executing pre-planned transactions pursuant to a Rule 10b5-1 plan that was established in good faith at a time when that person or entity was unaware of material non-public information has an affirmative defense against accusations of insider trading, even if actual trades made pursuant to the plan are executed at a time when the person or entity may be or is aware of material, non-public information.
- Rule 10b5-1 plans are especially useful for those presumed to have inside information, such as officers, directors and other affiliates.

What's the Deal?

Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder prohibit, among other things, the sale of a security on the basis of material non-public information. Rule 10b5-1 specifies that a sale constitutes trading on the basis of material non-public information when the person making the sale was aware of material non-public information at the time the sale was made. Rule 10b5-1, adopted in August 2000, codifies the position of the Securities and Exchange Commission ("SEC") that awareness, not use, of material non-public information is sufficient to establish liability in insider trading cases. Importantly, the rule creates a mechanism whereby any person or entity can enter into a trading plan (a "Rule 10b5-1 plan") that will provide an affirmative defense to a claim that a trade occurred "on the basis of" material non-public information. An affirmative defense allows a person to refute allegations of wrongdoing – in this case, trading on the basis of material non-public information. Rule 10b5-1 plans benefit both issuers and their insiders by offering greater clarity and certainty on how plan participants can structure securities transactions in order to avoid incurring insider trading liability.

Purpose of a Rule 10b5-1 Plan

A Rule 10b5-1 plan provides the following two affirmative defenses against allegations of insider trading so long as the person trading can demonstrate that the purchase or sale occurred pursuant to the terms of the plan.

- The first affirmative defense, available to both persons and entities, provides that trades pursuant to such a plan are not made "on the basis of" material non-public information.
- The second affirmative defense, available only to entities, provides that an entity will not be liable if it demonstrates that the person making an investment decision on behalf of the entity was not aware

of material non-public information and that the entity had implemented reasonable policies and procedures to prevent insider trading.

Once violations are alleged, the insider will need to set forth all of the elements of the defense, demonstrate that the Rule 10b5-1 plan was properly designed, and show that the trades at issue complied with the terms of the plan.

Benefits of a Rule 10b5-1 Plan

Rule 10b5-1 plans provide the following benefits:

- An affirmative defense to insider trading allegations as described above;
- Greater certainty to insiders in planning securities transactions;
- More opportunities for insiders to sell their securities, especially if the issuer's trading policy permits trading under such a plan during a blackout period;
- Less negative publicity associated with insider sales; and
- Decreased burden on counsel or trading compliance officers who otherwise would have to make subjective determinations about the availability or possession of material non-public information each time an insider seeks to effect a securities transaction.

While not a requirement, an issuer may choose to disclose the existence of certain Rule 10b5-1 plans in order to mitigate any negative press associated with insider securities transactions. An issuer making such a disclosure generally will disclose the existence of a plan but not the specific trading details. Disclosure of this information is typically made by way of a press release followed by a Form 8-K filing with the SEC or solely through a Form 8-K filing. The applicable Form 8-K item is Item 8.01, although Item 7.01 may be used under appropriate circumstances.

Establishing a Rule 10b5-1 Plan

Any person, including non-insiders, can establish a Rule 10b5-1 plan to effect securities transactions at a time when the person is not aware of material non-public information, so long as the plan is not part of a plan or scheme to evade the insider trading prohibitions of the rule. For example, an executive who receives a significant portion of his or her compensation in stock options may establish a Rule 10b5-1 plan to diversify his or her holdings or a director may establish a Rule 10b5-1 plan to purchase issuer securities to satisfy stock ownership guidelines. Either example is acceptable, so long as the person establishing the plan did not have access to material non-public information at the time the plan was established.

Elements of a Rule 10b5-1 Plan

A. Rule 10b5-1 plan provides an affirmative defense only if the following elements are met:

1. The plan was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1.

2. The plan was adopted at a time when the person trading was not aware of any material non-public information.
   - Rule 10b5-1 makes clear that trades are made "on the basis of" material non-public information when the person making the purchase or sale was merely "aware" of material non-public information, rather than "using" such information, when the purchase or sale was made.
3. The terms of the plan specified the amount, price, and date of the transaction(s) (or included a written formula, algorithm, or computer program for determining the amount, price, and date).
   - A simple plan may authorize trades on specified dates or at specified prices. A more complicated plan may utilize targets based on the performance of the stock relative to various market or industry indices or even relative to certain selected competitors.
   - The plan itself must sufficiently identify the calculation of the relevant prices and triggers so there is no discretion on the part of the insider. If desired, the plan should incorporate different trading strategies in order to provide flexibility.
4. The person trading under the plan did not exercise any subsequent influence over how, when, or whether to make purchases or sales.
   - Typically, the insider establishing the plan designates an administering broker who executes the trades pursuant to the plan.
   - Once the Rule 10b5-1 plan is adopted, there should be no communications between the insider and the administering broker (other than notices that trades have been executed).
   - Rule 10b5-1 prohibits both the insider or the appointed administering broker from entering into or altering a corresponding or hedging transaction or position with respect to securities subject to the plan.
5. The purchase or sale was made pursuant to the plan.
   - Rule 10b5-1(c)(1)(i)(C) specifies that a purchase or sale is not made pursuant to the plan if, among other things, the insider altered or deviated from the plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale).

Trading under a Rule 10b5-1 Plan

Securities Covered Under a Rule 10b5-1 Plan There is no restriction on the amount of securities that may be covered by a Rule 10b5-1 plan. A plan may be designed to cover all or a small portion of a person's holdings. The plan should be carefully constructed to include an amount that is suited to the purposes of the person trading. A plan that covers too few securities may require frequent modifications, and a plan that covers too many securities may make it difficult for the insider to take advantage of legitimate trading opportunities outside of the plan.

Rule 10b5-1(c)(1)(iii)(a) defines "amount" as either a specified number of securities or a specified dollar value of securities. Rule 10b5-1(c)(1)(iii)(b) defines "price" as the market price on a particular date or a limit price, or a particular dollar price. A Rule 10b5-1 plan can be set up to execute trades with minimum or maximum prices or with prices that change over time, so long as the price targets or the method for determining the price targets are set forth in the plan. Rule 10b5-1(c)(1)(iii)(c) defines "date" as, in the case of a market order, the specific day of the year on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution). In the case of a limit order, "date" is defined as a day of the year on which the limit order is in force.

Trade Frequency Under a Rule 10b5-1 Plan A plan can be tailored to the specific needs of the person who sets it up. For example, the plan can specify that trades will be made on a regular basis or the plan can be designed to initiate transactions upon certain trigger events. The SEC does not require a limit on the term of a Rule 10b5-1 plan. A series of short-term plans may subject the insider to allegations of manipulation. On the other hand, plans covering more than a year may deprive the insider of the ability to control the disposition (or acquisition) of securities or to react to significant changes in the issuer's condition or changes in the insider's financial circumstances.

Trades Deemed Outside a Rule 10b5-1 Plan Trades may be made outside of the Rule 10b5-1 plan. However, the Rule 10b5-1 affirmative defense will not apply to trades made outside of the plan. Additionally, an insider should not sell securities that have been designated as plan securities because any such sale may be deemed a modification of the plan. Further, if the insider is subject to the Rule 144 volume limitations, the sale of securities outside the plan could effectively reduce the number of shares that could be sold under the plan, which could be deemed an impermissible modification of the plan.

Changes to, or Termination of, Rule 10b5-1 Plans

Modifying a Rule 10b5-1 Plan While amendments to Rule 10b5-1 plans are permitted as long as the modifier does not possess material non-public information at the time of the modification and meets all of the elements required at the plan inception, modifications should be avoided, because they may create the perception that the person is manipulating the plan to benefit from material non-public information, jeopardizing the good faith element and the availability of the affirmative defense.

Suspending a Rule 10b5-1 Plan The affirmative defense will be unavailable if it appears that the person trading under the plan is exerting subsequent influence over the plan. In addition, suspension of a Rule 10b5-1 plan can lead to the same issues as modification of a plan: it may appear that the plan is being manipulated, jeopardizing the good faith element and the availability of the affirmative defense. When reinstating the ability to trade under the plan, all of the elements required at the inception of the plan must be met again.

Terminating a Rule 10b5-1 Plan Termination of a plan, by itself, is not a violation of Rule 10b-5, because the termination does not occur in connection with the sale or purchase of securities. However, termination of a plan may jeopardize the good faith element and the availability of the affirmative defense.

Once a Rule 10b5-1 plan is terminated, the affirmative defense may not apply to any trades that were made pursuant to that plan if such termination calls into question whether the good faith requirement was met or whether the plan was part of a plan or scheme to evade Rule 10b5-1. The problem is increased if the insider terminates and establishes plans serially.

Automatic Suspension or Termination of a Rule 10b5-1 Plan To allow persons to make decisions in connection with major corporate transactions and to avoid potential problems under other provisions of the federal securities laws, Rule 10b5-1 plans often include a provision that automatically terminates or suspends trading under the plan upon, among other occurrences, the issuer's announcement (or notice from an issuer's general counsel or compliance officer) of a merger or acquisition transaction or an underwritten public offering.

Impact on other Federal Securities Laws

A person trading pursuant to a Rule 10b5-1 plan still must comply with other regulatory reporting requirements. If a person is selling securities without registration under the Securities Act of 1933, the person may need to file a Form 144. On Form 144, the seller should indicate that the sale is being made pursuant to a Rule 10b5-1 plan. In addition, the seller may need to comply with the aggregation and volume restrictions of Rule 144.

For US issuers, the Forms 4 and 5 filing requirements also apply to trades made pursuant to a Rule 10b5-1 plan. It is advisable to specifically note on the Form 4 or 5 that the trades were made pursuant to a Rule 10b5-1 plan to ensure that investors or analysts monitoring sales by insiders will know that the trades do not represent a current investment decision by the insider. Additionally, trades made pursuant to a Rule 10b5-1 plan must be reported under the applicable requirements of Schedule 13D and/or Schedule 13G.

Officers, directors, and 10% shareholders utilizing Rule 10b5-1 plans should be careful about trading in violation of Section 16(b) of the Exchange Act. If such a person conducts a purchase and sale, in any order, within a six-month period and realizes a profit, then the profits must be disgorged to the issuer.

Insider Trading Policies

Trades made pursuant to Rule 10b5-1 plans are subject to issuer-specific trading restrictions and may not be permitted under an issuer's trading policy. Typically, an issuer's insider trading policy indicates whether an employee or director may establish a Rule 10b5-1 plan. Some insider trading policies require that a Rule 10b5-1 plan is approved or, at a minimum, that the plan has been established for its securities. An issuer may also require notice if an employee or director establishes a plan to trade securities of a significant customer or supplier. An employee or director should review the issuer's insider trading policy to determine whether the issuer permits establishment of a plan during a blackout period or permits trades during a blackout period pursuant to a plan.

Best Practices

To avoid the appearance that insiders are engaging in abusive practices issuers should adopt the following requirements for Rule 10b5-1 plans by their directors, officers, and other employees:

- **Establishment of a Plan** Require issuer approval of any Rule 10b5-1 plan and permit plans to be established only during an open trading window to avoid the appearance of establishing a plan while in possession of material non-public information and to bolster the good faith element.

- **Waiting Period** Impose a mandatory waiting period between the establishment of a plan and the date the initial trade is made.
- **Term of Plan** Consider minimum and maximum terms for plans, such as a minimum of six or 12 months and a maximum of two years. This will enable users to establish new plans over time while preventing the need for any voluntary modifications, terminations, or suspensions.
- **Form Plan** Consider adopting a pre-approved form of plan.
- **One Broker** Consider requiring all insiders to use a pre-selected broker.
- **Trading Parameters:** Consider prohibiting large sales at initiation of the plan or plans that give the implementing broker discretion on sales.
- **Modifications, Terminations, Suspensions** Disallow any modification, termination, or suspension other than during open trading windows. In the event of any modification, termination, or suspension, issuers should impose a waiting period before trades can be reinstated under a plan.
- **Disclosure** Disclose all events in the lifecycle of a Rule 10b5-1 plan: adoption, modification, termination, or suspension, either through a press release or by a Form 8-K.
- **Multiple Plans** Prohibit insiders from adopting multiple overlapping Rule 10b5-1 plans.
- **Trades Outside of the Plan** Once a plan is established, limit transactions outside of the plan.

In addition, the issuer should develop robust training programs regarding its insider trading and disclosure policies and the use of Rule 10b5-1 plans, and should consider periodic reviews of insiders' trading plans to ensure compliance with the securities laws and issuer policies.

Checklist of Key Questions

- Does the issuer require approval of a Rule 10b5-1 plan?
- What is the duration of the Rule 10b5-1 plan?
- Does the issuer require all insiders to use a pre-selected broker?
- Does the issuer prohibit large sales at initiation of the plan or plans that give the implementing broker discretion on sales?
- Does the issuer prohibit any modification, termination, or suspension other than during open trading windows?
- If there is a modification, termination, or suspension to the plan, has the issuer imposed a waiting period before trades can be reinstated under a plan?
- Does the issuer publicly disclose the existence of insider Rule 10b5-1 plans?
- Once a plan is established, does the plan limit transactions outside of the plan?

Here's the deal:

- Rule 144A is an exemption from the registration requirements of Section 5 of the Securities Act of 1933 (the "Securities Act") for offers and sales of qualifying securities by persons other than the issuer of the securities.
- As a condition of the Rule 144A exemption, the resale must be made only to a qualified institutional buyer ("QIB") or to a purchaser that the reseller (and any person acting on its behalf) reasonably believes to be a QIB, and the reseller must take reasonable steps to ensure that the purchaser is aware that the reseller is relying on Rule 144A in connection with the resale.
- Not all securities are eligible for resale pursuant to Rule 144A. Securities offered in reliance on Rule 144A must not be "fungible" with, or substantially identical to, a class of securities listed on a national securities exchange or quoted on an automated inter-dealer quotation system. Issuers must also be willing to provide or make available certain reasonably current information about the issuer to any purchasers.
- Rule 144A transactions may include (1) offerings of debt, convertible debt or preferred securities by public companies; (2) offerings by foreign issuers that do not want to become subject to U.S. reporting requirements; and (3) offerings of common stock by non-reporting issuers (i.e., "backdoor IPOs").
- Rule 144A is an attractive option for continuous offering programs, particularly those that offer complex securities and are not aimed at retail investors.

What's the Deal?

Every security offered or sold in the United States must either be registered with the U.S. Securities and Exchange Commission (the "SEC") under Section 5 of the Securities Act or must qualify for an exemption from such registration requirements. The Rule 144A exemption applies to resales to QIBs of qualifying securities by certain persons other than the issuer of the securities. Resellers that rely on the exemption are not "underwriters" within the meaning of Section 2(a)(11) of the Securities Act, as Rule 144A provides that reoffers and resales made in compliance with the rule are not "distributions." Resellers that are not issuers, underwriters, or dealers may rely on the exemption provided by Section 4(a)(1) of the Securities Act while resellers that are dealers may rely on Section 4(a)(3) of the Securities Act.

Under Rule 144(a)(3) of the Securities Act, securities acquired in a Rule 144A transaction are "restricted securities." Unless the securities are subsequently registered (for example, if a registration statement was filed pursuant to a registration rights agreement for the applicable securities), the securities will remain restricted for the duration of the applicable holding period. Resales of restricted securities may only be made in reliance on an applicable exemption under the Securities Act. In addition to Rule 144, exempt resales of restricted securities also may be made in compliance with Rule 144A, the Section 4(a)(1½) exemption, Section 4(a)(7), or Regulation S.

At the state level, Section 18 of the Securities Act exempts Rule 144A transactions from state regulation if (i) the issuer of the securities being resold in the Rule 144A transaction has a class of securities listed and traded on the New York Stock Exchange, NYSE Amex or the Nasdaq Market System, and (ii) the securities being resold in the Rule 144A transaction are equal or senior to the issuer's listed securities. For Rule 144A offerings of issuers without securities that are so listed, most state securities laws contain an exemption from registration for reoffers and resales made to QIBs within the meaning of Rule 144A or an institutional investor exemption broad enough to encompass QIBs.

Rule 144A offerings are also exempt from filing under FINRA's Corporate Financing Rule and FINRA's requirement to file private placement documents.

Financial institution and insurance company issuers often use Rule 144A continuous issuance programs for multiple offerings (usually of debt securities) to potential offerees. Rule 144A programs are generally similar to "medium-term note programs," but they are sold only to QIBs.

Eligible Purchasers

As a condition of Rule 144A, the resale may be made to a purchaser that the reseller (and any person acting on its behalf) reasonably believes is a QIB. A QIB is an institution (not a natural person), foreign or domestic, included within one of the categories of institutional "accredited investors" defined in Rule 501 of Regulation D, acting for its own account or the accounts of other QIBs that meets certain financial thresholds (outlined in greater detail below). A reasonable belief that the purchaser is a QIB may be established based on a QIB representation letter or based on recent financial information about the entity. Recent financial information may include publicly available annual financial statements, information filed with a governmental agency or self-regulatory organization, a certification by the entity's chief financial or other executive officer, or information in a recognized securities manual, in each case, as of a date not more than 16 months for a domestic entity or 18 months for a foreign entity preceding the sale.

To be considered a QIB, an entity must also, in the aggregate, own and invest on a discretionary basis at least $100 million in securities ($10 million for a broker-dealer) of issuers not affiliated with the entity. QIBs that are banks and savings and loan associations must also have a net worth of at least $25 million. Entities formed solely for the purpose of acquiring restricted securities in a Rule 144A transaction will be QIBs, provided that they satisfy the QIB requirements.

To determine whether an entity owns and invests the requisite amount of securities, the value of the securities is typically calculated on a cost basis. However, an entity may use fair market value basis where it does so for financial reporting purposes and no current information with respect to the cost of such securities has been published. If an entity reports both cost and fair market values of the securities it holds, only the cost valuation method will be used to determine whether that entity is a QIB. The value of the securities to be purchased in the Rule 144A transaction may not be included in an entity's aggregate total, and bank deposit notes, certificates of deposit, loan participations, repurchase agreements, and currency, interest rate, and commodity swaps must also be excluded. Securities held by an entity's consolidated subsidiaries may be included if such securities are managed by that entity and either (i) the entity is a reporting company under the Securities Exchange Act of 1934 (the "Exchange Act") or (ii) the entity itself is not a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise.

A broker-dealer acting as a riskless principal for a QIB will also be deemed to be a QIB. In a riskless principal transaction, the broker-dealer must have a commitment from its customer, the QIB, that it will simultaneously purchase the securities from the broker-dealer. This commitment must be in place at the time of purchase in the Rule 144A transaction.

In establishing a reasonable belief that a potential purchaser is a QIB, a seller has no obligation to confirm the validity of any information and may rely on available information that shows an entity is a QIB, even where more recent information is available (including where the more recent information indicates that a purchaser now holds fewer securities). However, a seller cannot rely on information or certifications that it knows, or is reckless in not knowing, are false.

Eligible Securities

The eligibility of the securities that can be offered in reliance on Rule 144A is determined at time of issuance. To rely on Rule 144A, the securities must not be fungible with a class of securities listed on a U.S. national securities exchange or quoted on a U.S. automated inter-dealer quotation system, and must not be securities of an open-end investment company, unit investment trust, or face-amount certificate company that is, or is required to be, registered under the Investment Company Act of 1940. Because eligibility for Rule 144A purposes is determined at the time of issuance, securities of the same class that are thereafter listed will not affect Rule 144A eligibility.

Whether a security is deemed to be fungible with or of the same class as listed securities depends on the type of security:

- Common stock, preferred stock, and debt securities are deemed to be of the same class if the material terms and the rights and the privileges of the holders of the class of securities are substantially the same as those of the listed securities. American Depositary Receipts ("ADRs") are of the same class as the underlying securities.
- Warrants with a term less than three years or an effective exercise premium at pricing of the Rule 144A offering of less than 10% will be treated as the same class as the underlying security. The exercise premium is calculated by: (i) taking its price at issuance; (ii) adding to such price its aggregate exercise price; (iii) subtracting from such number the aggregate market value (as of the pricing day of the warrants) of the securities that would be received on exercise; and (vi) dividing the difference by the amount subtracted in (iii).

- Convertible or exchangeable securities with an effective conversion premium at pricing of the Rule 144A offering of less than 10% are considered to be of the same class as the underlying security. The effective conversion premium is calculated by: (i) taking its price at issuance; (ii) subtracting from such price the aggregate market value (as of the pricing day of the convertible securities) of the securities that would be received on conversion; and (iii) dividing the difference by the amount subtracted in (ii).

As described above, securities acquired in a Rule 144A resale are deemed to be "restricted securities" within the meaning of Rule 144(a)(3) of the Securities Act; i.e., they are not freely tradeable absent an exemption or registration of the resale under the Securities Act until the end of the applicable holding period under Rule 144. A six-month holding period is required for restricted securities of an issuer that has been a reporting company under the Exchange Act for at least 90 days and is current in those reporting obligations at the time of sale. A one-year holding period is required for restricted securities of a non-reporting company or a reporting company that is not current in its reporting obligations at the time of sale. As a result of the limitations on resale, and the related reduction in liquidity, the seller must make the purchaser aware that the securities are being sold pursuant to Rule 144A. Typically this is achieved by placing a legend on the security itself and including appropriate notice in the offering documentation. The securities will also be assigned a restricted CUSIP number.

Conducting Traditional Rule 144A Transactions

Rule 144A Offering Process

The Rule 144A offering process is often similar to the public offering process. Typically, a "red herring," or preliminary offering memorandum, is distributed to investors for the purpose of soliciting orders. Once the offering prices, a final term sheet is delivered to investors to indicate the final pricing terms and confirm orders. The comfort letter from the issuer's auditors will also be delivered to the initial purchasers at pricing. The closing usually takes place three to five days after pricing. The legal opinions and other closing documents will be delivered at closing.

Rule 144A Offering Documentation

Unlike SEC-registered offerings, there are no specific SEC disclosure requirements for Rule 144A offerings. However, to avoid potential liability to the initial purchasers, Rule 144A offering documents are quite similar to the prospectuses prepared for SEC-registered offerings in terms of the scope and depth of disclosure. The documentation used in a Rule 144A transactions is also similar to that used in registered offerings, and includes:

- An offering memorandum, which typically contains a detailed description of the issuer, including its business and financial results, and the details of the securities to be offered, as well as risk factors, a discussion of the issuer's management, tax considerations, and other matters. If the issuer is an Exchange Act reporting company, the offering memorandum will incorporate by reference the issuer's Exchange Act filings, making the document significantly shorter. The offering memorandum will also include an appropriate notice to the investors regarding the restricted nature of the 144A securities and a section detailing transfer restrictions.

- A purchase agreement between the issuer and the initial purchasers that provides that the initial purchasers (equivalent to underwriters in a registered offering) may directly or through U.S. broker-dealer affiliates arrange for the offer and resale of securities within the United States only to QIBs pursuant to Rule 144A. The form, organization, and content of the purchase agreement often resembles an underwriting agreement for a public offering in many respects, but is modified to reflect the manner of offering.
- In some cases, a registration rights agreement between the issuer and the initial purchasers will also be executed by the parties. Occasionally, purchasers may require registration rights. The two principal methods to register Rule 144A securities under the Securities Act are Exxon Capital exchange offers and resale shelf registrations under Rule 415 of the Securities Act. Because of certain administrative issues, Exxon Capital exchange offers are the preferred means for providing holders of Rule 144A securities with freely tradable securities.
- Closing documents, including legal opinions, comfort letters, officer's and secretary's certificates, and other customary deliverables will also accompany an offering.

Information Required to be Delivered for Non-Reporting Issuers

Specific information is required to be delivered to the purchasers under Rule 144A if the issuer is <u>not</u> a reporting company under the Exchange Act, a foreign company exempt from reporting under Rule 12g3-2(b), or a foreign government. In those cases, the holder of the securities and any prospective purchaser designated by the holder must have the right to obtain from the issuer, upon request, a brief description of the issuer's business, products, and services and the issuer's most recent audited financial statements. The information provided must be "reasonably current" in relation to the date of resale under Rule 144A, generally as of a date within 12 months prior to the resale for U.S. issuers and within the timing requirements imposed by the jurisdiction of a non-U.S. issuer. This right to information, required under Rule 144A, is agreed to by the issuer with the initial purchasers in the purchase agreement.

Rule 144A Offering Liability and Due Diligence Investigation

Although initial purchasers and issuers in a Rule 144A offering are not subject to liability under Section 11 of the Securities Act, they could be subject to liability for material misstatements and omissions under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. As a result of potential liability under Section 10(b) and Rule 10b-5, an offering memorandum for a Rule 144A offering usually contains information comparable to what a prospectus for a registered offering would contain.

The "due diligence" defense for underwriters that may be established under Section 11 of the Securities Act (but not issuers, who are strictly liable) is only applicable to registered offerings, not Rule 144A offerings. Nonetheless, a due diligence investigation will result in better and more thorough disclosure, and also enables the initial purchaser to evaluate the relevant risks and to decide whether to undertake an offering.

As with a registered offering, the Rule 144A due diligence process consists of business and management due diligence and documentary (or legal) due diligence. The initial purchasers in a Rule 144A offering and their counsel will conduct a review of the issuer's public filings and other publicly available information; verify company information through independent sources; undertake a close review of the issuer's financial statements, corporate documents, and key contracts; conduct interviews with management, key employees, and site visits; and obtain appropriate legal opinions and comfort letters.

Rule 159 Under the Securities Act

Rule 159 provides that the adequacy of the disclosure in a prospectus is evaluated as of the time that an investor forms a contract to purchase the securities and that no information provided after that time may be considered for purposes of liability determinations with respect any misstatements or omissions in the offering materials.

As a general practice, the purchase contract is usually delivered before the final prospectus. To meet the Rule 159 standard, in registered offerings, especially in debt offerings, the issuer or the underwriters usually provide investors with a final term sheet or similar document with the information that was not included in the preliminary prospectus, such as pricing-specific information or corrections to the preliminary prospectus at the time of pricing. Although Rule 159 only applies to registered public offerings, Rule 144A offerings tend to adopt this practice, including the delivery of term sheets and required statements in legal opinions and officer certificates, based on concerns that a court could apply a similar standard in evaluating the sufficiency of disclosure in a Rule 144A offering.

Concurrent Regulation S Offering

Regulation S under the Securities Act provides another exemption from the registration requirements of the Securities Act. Regulation S applies to securities offered and sold outside the U.S. to non-U.S. persons. It is very common to have a Rule 144A tranche offered to QIBs and a Regulation S tranche offered to non-U.S. purchasers. In order to ensure lawful transfer in the secondary market, these tranches are usually represented by separate global certificates because Regulation S debt securities usually have a restricted holding period that is shorter than the Rule 144 holding period. In such a case, the Rule 144A global certificate with a Rule 144A restrictive legend is deposited with The Depository Trust Company ("DTC"), while the Regulation S global certificate with a Regulation S restrictive legend is deposited with a European clearing system. The Rule 144A securities can be re-sold to non-U.S. purchasers that are not QIBs if the sale complies with Regulation S. Similarly, the Regulation S securities can be re-sold in the U.S. to QIBs if the resale complies with Rule 144A. The registrar of the securities will track increases or decreases in the respective certificates.

Subsequent Registration

Securities sold pursuant to Rule 144A may be subsequently registered under the Securities Act pursuant to a registration rights agreement (as described above); however, it is also possible for an issuer to become obligated to register equity securities sold pursuant to Rule 144A even where a registration rights agreement was not executed in connection with the transaction.

Rule 144A Offering Market And Recent Trends

Rule 144A now permits general solicitation and general advertising, provided that actual sales are only made to persons that are reasonably believed to be QIBs. Consequently, prior practices for Rule 144A offerings, such as internet road shows available to QIBs only and using password protection, are no longer technically required, although initial purchasers continue to limit the use of general solicitation. For Regulation S offerings with a Rule 144A tranche, general solicitation and general advertising in connection with the Rule 144A tranche will not be viewed by the SEC as "directed selling efforts" in connection with the concurrent Regulation S offering.

Checklist of Key Questions

- Is the security eligible for Rule 144A?
- Are the purchasers QIBs?
- Will the Rule 144A offering be made concurrent with a Regulation S offering?
- Is the issuer an Exchange Act reporting company? If not, will the issuer be able to provide the required information to investors following the offering?
- What type of offering is contemplated – is it a Rule 144A for life offering? A traditional Rule 144A offering?
- Will the issuer commit to provide registration rights?
- Has diligence satisfactory to the initial purchasers been conducted?
- Will the issuer offer securities contemporaneously in a private placement?

Section 3(a)(2) Bank Note Programs

Here's the deal:

- Section 3(a)(2) bank note programs are medium-term note programs with a "bank" as the issuer
- The issuer must be a "bank," as defined in Section 3(a)(2) of the Securities Act
- Bank note programs allow the issuer to access the market quickly without the delay associated with SEC review and to do so on a regular or continuous basis
- Securities issued pursuant to a Section 3(a)(2) bank note program are exempt from SEC registration

What's the Deal? – What is Section 3(a)(2)?

Section 3(a)(2) of the Securities Act of 1933 (the "Securities Act") exempts from registration under Section 5 of the Securities Act any security issued or guaranteed by a "bank." The policy underlying this exemption from the registration requirements of Section 5 of the Securities Act is that banks are highly regulated, and provide adequate disclosure to investors about their businesses and operations in the absence of federal securities registration requirements. Banks are also subject to various regulatory capital requirements that may serve to increase the likelihood that holders of their debt securities will receive timely payments of principal and interest.

What is a "bank?"

Under Section 3(a)(2), an institution must meet both of the following requirements: (1) it must be a national bank or an institution supervised by a state banking commission or similar authority and (2) its business must be substantially confined to banking. Entities that sound like banks but do not qualify include, bank holding companies, finance companies, investment banks and foreign banks. As discussed below, regulated U.S. branches and agencies of foreign banks may qualify as a "bank."

What types of securities are generally issued pursuant to bank note programs?

Common types of issuances include senior or subordinated debt securities, such as fixed or floating rate, zero-coupon, non-U.S. dollar denominated, amortizing, multicurrency or indexed ("structured" or "market-linked") debt securities. Most bank note programs are rated "investment grade" by one or more nationally recognized credit rating agencies, as further discussed below. Bank issuers often use bank note programs to issue Section 3(a)(2) structured notes, the payments on which are linked to the performance of specified reference assets not always seen in registered programs, such as complex underlying assets, credit-linked notes, small-cap stocks and non-U.S. stocks, that do not trade on U.S. securities exchanges.

Is a non-U.S. bank an eligible issuer for a Section 3(a)(2) bank note program?

Generally, no. However, U.S. branches or agencies of foreign banks are conditionally entitled to rely on the Section 3(a)(2) exemption. In 1986, the U.S. Securities and Exchange Commission ("SEC") took the position that a foreign branch or agency would be deemed a "national bank" or a "banking institution organized under the laws of any State, Territory, or the District of Columbia," if "the nature and extent of federal and/or state regulation and supervision of that particular branch or agency is substantially equivalent to that applicable to federal or state chartered domestic banks doing business in the same jurisdiction."[1] It is the responsibility of the issuer and its counsel to make the determination with respect to the requirement of "substantially equivalent regulation," as well as the determination as to whether the business of the branch or agency in question "is substantially confined to banking and is supervised by the State or territorial banking commission or similar official." As a result, U.S. branches or agencies of foreign banks are frequent issuers or guarantors of debt securities in the United States. Most U.S. branches have elected the N.Y. State Department of Financial Services ("NYDFS") as their primary regulator with their secondary regulator being the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Some U.S. branches have opted for the Office of the Comptroller of the Currency ("OCC") as their primary regulator.

How does a guarantee allow a non-bank issuer to issue under Section 3(a)(2)?

Section 3(a)(2) also exempts from registration under Section 5 of the Securities Act securities guaranteed by a bank. This guarantee is not limited to a guarantee in a legal sense, but also includes arrangements in which the bank agrees to ensure the payment of a security. The guarantee or assurance of payment, however, has to cover the entire obligation; it cannot be a partial guarantee or promise of payment, and it must be unconditional. Guarantees by foreign banks (other than those of an eligible U.S. branch or agency) would not qualify for this exception. The guarantee is a legal requirement to qualify for the exemption; investors will not look to the U.S. branch for payment/credit. Investors will look to the home office. Foreign banks and finance companies, for example, can rely on the Section 3(a)(2) exemption if the securities they issue are guaranteed by a bank.

Do state or federal banking regulators impose any conditions on bank note programs?

National banks or federally licensed U.S. branches or agencies of foreign banks regulated by the OCC are subject to the OCC's securities offering disclosure rules (12 C.F.R. Part 16). The securities offering disclosure rules provide that national banks may not offer and sell their securities until a registration statement has been filed and declared effective with the OCC, unless an exemption applies.

An OCC registration statement is generally comparable in scope and detail to an SEC registration statement; as a result, most bank issuers prefer to rely upon an exemption from the OCC's registration requirements. Section 16.5 of the securities offering disclosure rules provides a list of exemptions, which includes Regulation D offerings, Rule 144A offerings to qualified institutional buyers and Regulation S

[1] Securities Issued or Guaranteed by United States Branches or Agencies of Foreign Banks, SEC Release No. 33-6661 SEC Docket (1973-2004), 36 SEC-DOCKET 746-1 (September 23, 1986).

offerings made outside of the United States. General solicitation would be allowed for Regulation D offerings and Rule 144A offerings; the Rule 506 "bad actor" disqualification provisions would also apply.

Part 16.6 of the securities offering disclosure rules provides a separate partial exemption for offerings of "non-convertible debt" made to accredited investors in denominations of $250,000 or more. Federal branches or agencies of foreign banks, as issuers, may rely on this exemption by furnishing to the OCC parent bank information that is required under Securities Exchange Act of 1934 ("Exchange Act") Rule 12g3-2(b) and to purchasers the information required under Securities Act Rule 144A(d)(4)(i). The securities must be "investment grade" — the definition focuses on the probability of repayment rather than on an external investment grade rating (a Dodd-Frank Act requirement). Prior to, or simultaneously with, the sale of the securities, the purchaser must receive an offering document that contains a description of the terms of the securities, the use of proceeds and the method of distribution, and incorporates certain financial reports or reports filed under the Exchange Act. The offering document and any amendments must be filed with the OCC no later than the fifth business day after they are first used.

Are there any relevant regulations affecting securities offerings by state regulated banks?

Currently, offerings of securities made by state non-member banks are subject to the Statement of Policy Regarding the Use of Offering Circulars in Connection with Public Distribution of Bank Securities (the "1996 FDIC Policy"). The 1996 FDIC Policy affects state nonmember banks (banks that are supervised by the FDIC rather than the Federal Reserve) and state-licensed branches of foreign banks with insured deposits. The 1996 FDIC Policy requires that an offering circular include prominent statements that the securities are not deposits, are not insured by the FDIC or any other agency, and are subject to investment risk. The 1996 FDIC Policy also states that the offering circular should include detailed prospectus-like disclosure, similar to the type contemplated by Regulation A or the offering circular requirements of the former Office of the Thrift Supervision ("OTS"). The 1996 FDIC Policy has not been updated to reflect the elimination of the OTS. In practice, bank issuers include offering circular disclosure that is more detailed than that required by the 1996 FDIC Policy due to liability concerns.

On January 19, 2021, the FDIC proposed rescinding the 1996 FDIC Policy and replacing it with a new regulation to be codified in Subpart A of 12 C.F.R. Part 335, as "Securities of State Nonmember Banks and State Savings Associations" (the "Proposed Rule").[2] The Proposed Rule is limited in its scope as opposed to the 1996 FDIC Policy, which applies to all state nonmember banks. The Proposed Rule applies to offerings of bank securities in the following circumstances: (1) FDIC-supervised institutions (*i.e.*, state nonmember banks and state savings associations) in organizations; (2) FDIC-supervised institutions subject to an enforcement order or capital restoration plan that intend to issue securities; (3) FDIC-supervised institutions converting from a mutual to stock form of ownership; and (4) subsidiaries of state savings associations in any of (1)-(3).

[2] The Proposed Rule is available at: Federal Register: Transferred OTS Regulations Regarding Securities Offerings of State Savings Associations, Statement of Policy on the Use of Offering Circulars, Proposed Rulemaking Regarding Securities Offerings by State Nonmember Banks and State Savings Associations, and Other Technical Amendments.

Unlike under the 1996 FDIC Policy, an insured state nonmember bank issuing debt securities outside of (1)-(3) above would not be subject to the Proposed Rule. However, the Proposed Rule is instructive as to the type of disclosure to include in an offering circular for an offering of bank securities by a state nonmember bank and the FDIC indicates that, in its experience, many state nonmember banks comply with federal securities offering rules even if they are not legally required to do so.

State nonmember banks and state savings associations subject to the Proposed Rule would be required to file a registration statement, including a prospectus, with the appropriate regional FDIC office, notwithstanding the availability of the Section 3(a)(2) exemption. The registration statement and prospectus would need to conform to Regulation C under the Securities Act unless provided otherwise in the Proposed Rule. With respect to disclosure, the documents would need to conform to the requirements of Regulations S-K and S-X under the Securities Act. As in the 1996 FDIC Policy, the standard legends (*i.e.,* the securities are not deposits, not FDIC-insured, no approval by the FDIC is implied and debt securities are subordinated to deposits) would need to be included in the offering circular in bold capital letters.

New York branches or agencies of foreign banks should contact the NYDFS prior to issuing bank notes. An agency of a foreign bank subject to New York banking regulations should obtain a pre-offer no-objection letter from the Superintendent of the NYDFS, and would be able to sell only to certain authorized institutional purchasers in minimum denominations of $100,000. New York branches of foreign banks typically issue bank notes in high minimum denominations in order to avoid the notes being viewed by a regulator as an impermissible retail deposit. This limitation does not apply when the New York branch is a guarantor and the issuing entity is the foreign bank.

Are there any FINRA filing requirements?

Even though securities offerings under Section 3(a)(2) are exempt from registration under the Securities Act, public securities offerings conducted by banks must be filed with the Financial Industry Regulatory Authority, Inc. ("FINRA") for review under Rule 5110(b)(9), unless an exemption is available. The exemption most used for bank note programs is that the issuer has outstanding investment grade rated unsecured non-convertible debt with a term of issue of at least four years or the non-convertible debt securities to be issued under the bank note program are so rated.

If an affiliated dealer is an agent for the offering, there is "prominent disclosure" in the offering document with respect to the conflict of interest caused by that affiliation and the bank notes are rated investment grade or in the same series that have equal rights and obligations as investment grade rated securities, then no qualified independent underwriter will be required.

Is there a minimum denomination requirement?

The Section 3(a)(2) exemption is not conditioned on a specific minimum denomination. However, for a variety of reasons, denominations may at times be significantly higher than those for retail transactions:

- offerings targeted to institutional investors;

- complex securities; and
- the relationship to Part 16.6's requirement of $250,000 minimum denominations.

Is any action required under the state securities, or blue sky, laws?

Securities issued under Section 3(a)(2) are considered "covered securities" under Section 18 of the Securities Act. However, because bank notes are not listed on a national securities exchange, states may require a notice filing and a fee in connection with an offering of bank securities. Generally, blue sky filings are not needed in any state in which the securities are offered. State blue sky laws should be examined to ensure that either no notice filing or fee is required or if the state's existing exemption for securities issued by banks does not require a filing. A state may not view an agency of a foreign bank, the securities of which are eligible for the Section 3(a)(2) exemption, as within the state's exemption for securities issued by banks.

What kind of offering documentation is used in bank note programs?

The offering documentation for bank notes is similar to that of a registered debt offering. Issuers use a base offering document, which may be an "offering memorandum" or an "offering circular" (instead of a "prospectus"). For foreign issuers, International Financial Reporting Standards ("IFRS") financials or "home country" GAAP financials are acceptable. However, offering documents of foreign issuers will need a reconciliation footnote or explanation if non-U.S. GAAP or non-IFRS is used. U.S. GAAP financials are preferable. The market demands annual audited and at least semiannual unaudited financial statements. Typically, the equivalent of Industry Guide 3 statistical disclosures (now, Regulation S-K subpart 1400) or something similar are included.

The base document is supplemented for a particular offering by one or more "pricing supplements" and/or, in the case of structured notes, "product supplements." These offering documents may be supplemented by additional offering materials, including term sheets and, for structured products, brochures.

How does a bank initiate a bank note program?

One threshold question is whether the bank has an affiliated dealer that may be the lead dealer for the program. If the affiliated dealer does not have expertise in the particular market (*e.g.,* structured products), an unaffiliated dealer with expertise should be brought in. If the bank plans to issue structured products, it should engage a dealer that is familiar with FINRA's suitability rules and Regulation Best Interest under the Exchange Act and has internal compliance procedures in place for sales of structured products.

If a foreign bank is the issuer, the dealer may have particular views as to acceptable financial statements. If the dealer plans on distributing through third-party dealers, the issuer should inquire about the dealer's "know your distributor" policies. If the issuer uses an affiliated dealer, the appropriate FINRA filing exemption must be used. Dealer's counsel will want to start its diligence early in the process in order to identify any potential issues.

The offering circular tends to have information similar to that in a registered offering due to liability concerns. As a guide, one could look to the content requirements in Part 16.6 of the securities offering disclosure rules:

- description of the business of the issuer similar to that included in a Form 10-K;
- description of the terms of the notes;
- use of proceeds; and
- method of distribution.

A U.S. bank will incorporate by reference into the offering circular the Exchange Act reports filed by its parent bank holding company, together with the bank's Call Reports.

Branches or agencies of foreign banks' disclosure is very limited – usually the address, primary business lines and the date of establishment. Disclosure about the parent or headquarters is usually sufficient. If a guarantee structure is used, a description of the guarantee will be included. Bank note programs for structured products will have product and pricing supplements for particular structures.

The distribution agreement is very similar to a distribution agreement for a registered medium-term note program. In negotiating the distribution agreement, attention should be paid to the required deliverables (comfort letters, officers' certificates and opinions) and when they will be delivered. Generally, these deliverables are delivered at the program launch and may also be delivered on a quarterly basis for active bank note programs. If there is a large, benchmark-size takedown from the bank note program, the agents on the program will require a full set of deliverables for that takedown.

The scope of the opinions should be negotiated early in the process. Consider whether there will be multiple counsel delivering legal opinions (U.S., non-U.S., internal, dealers' counsel). Issuers should plan for future, regular diligence sessions with the agents. If the issuer has designated dealers' counsel, they will have a preference as to the form of the distribution agreement.

Unlike registered medium-term note programs, bank note programs generally do not use an indenture. Qualification of an indenture under the Trust Indenture Act of 1939 is not required for an exempt offering. Instead, a fiscal and paying agency agreement is generally used. Disclosure in the description of the notes should clearly point out the differences between an indenture and a fiscal and paying agency agreement; *i.e.,* there is no trustee in a fiduciary relationship with the note holders and note holders have to accelerate their own note if there is an event of default.

What liabilities flow to the issuer from offerings under a bank note program?

Securities offerings of, or guaranteed by, a bank under Section 3(a)(2) are not subject to the civil liability provisions under Section 11 and Section 12(a)(2) of the Securities Act. These offerings are subject to Section 10(b) of the Exchange Act and the anti-fraud provisions of Rule 10b-5 of the Exchange Act. This has an impact on the content of offering documents and the use of offering circulars to convey material information and risk factors.

Rule 10b-5 applies to registered and exempt offerings. Rule 10b-5 of the Exchange Act prohibits:

- the use of any device, scheme, or artifice to defraud;
- the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements made not misleading; or
- engaging in any act, practice, or course of business that would operate to deceive any person in connection with the purchase or sale of any securities.

To bring a successful cause of action under Rule 10b-5, plaintiffs must prove:

- that there was a misrepresentation or failure to disclose a material fact;
- that the misrepresentation was made in connection with plaintiffs' purchase or sale of a security;
- that defendants acted with "scienter," or the intent or knowledge of the violation;
- that plaintiffs "relied" on defendants' misrepresentation or omission; and
- that such misrepresentation or omission caused plaintiffs' damages.

Checklist of Key Questions

- Is the issuer or the guarantor a bank?
- Does the issuer have an affiliated broker-dealer that will be involved in the bank note program?
- If the issuer is a foreign bank is there a guarantee by a U.S. branch or agency?
- Will the issuer's financial statements be prepared in compliance with IFRS or U.S. GAAP?
- If the bank note program is intended to be used to offer and sell structured products, does the lead dealer have experience in this area?
- Will the bank note program be rated investment grade or be *pari passu* with securities of the same issuer that are so rated?

Shelf Registration Statements and Shelf Takedowns

Here's the deal:

- An effective shelf registration statement allows an issuer to be in a position to complete multiple offerings from time to time in the future without having the timing of any such offering delayed by a possible SEC review.
- In a continuous offering, issuers may offer securities promptly following the declaration of effectiveness of a shelf registration statement and do so pursuant to an offering program, such as a medium-term note program.
- Alternatively, when the issuer has no present intention to offer securities, and intends to do so from time to time in the future in distinct offerings, the issuer will be said to be conducting a series of delayed offerings.
- A shelf registration statement may be used for a variety of types of offerings, including at-the-market offerings, depending on the issuer's needs

What's the Deal?

The shelf registration process allows an issuer to file a registration statement with the Securities and Exchange Commission ("SEC") in order to register a public offering, when the issuer has no present intention to sell the securities being registered. A shelf registration statement permits multiple offerings off of the same shelf registration statement and it can be used for the sale of new securities by the issuer ("primary offerings"), the resale of outstanding securities held by securityholders ("secondary offerings"), or a combination of both.

With an effective shelf registration statement, when the issuer wants to offer securities, it takes them "off the shelf." These "shelf takedowns" are usually offered pursuant to a base prospectus (contained in the registration statement) and a prospectus supplement. Securities are usually registered for sale either on a continuous or a delayed basis, although a portion of the securities may be offered immediately.

Benefits of a Shelf Registration Statement

The primary advantages of a shelf registration statement are timing and certainty. An effective shelf registration statement enables an issuer to access the capital markets quickly when necessary or when market conditions are optimal. As noted above, once an issuer's shelf registration statement has been declared effective, no SEC review is required in connection with subsequent takedowns.

When a specific offering is planned, a prospectus supplement that describes the terms of the offering must be filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the

"Securities Act") within the time period specified in the relevant provision of Rule 424(b) that is being relied on in connection with the supplement filing.

In the case of a shelf registration statement on Form S-3 (for US issuers) or Form F-3 (for foreign private issuers), the registration statement may provide historical information by relying on incorporation by reference from the issuer's reports previously filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and also can incorporate Exchange Act reports that are filed by the issuer after the shelf registration statement's effective date. The ability to forward incorporate will allow the issuer to ensure that the shelf registration statement remains current, without having to undertake amendments.

Takedowns from an effective shelf registration can be made without SEC Staff review or delay. Unlike a post-effective amendment, a prospectus supplement does not have to be declared effective by the SEC Staff.

Differences Between a "Continuous" Offering and a "Delayed" Offering

In a "continuous offering," securities are offered promptly after effectiveness of the registration statement (within two days) and will continue to be offered from such date forward. The term "continuous" only applies to offers of the securities, not to sales of the securities, as sales may be made sporadically over the duration of the continuous offering.

By contrast, in a "delayed offering," there is no present intention to offer securities at the time of effectiveness. Generally, only more "seasoned" issuers that are "primarily eligible" to use Form S-3 or Form F-3 may engage in delayed primary offerings. In a delayed primary offering, the issuer typically will file a "core" or "base" prospectus as part of the initial filing of the registration statement. The actual terms and specifics of an offering will be filed after effectiveness of the shelf registration statement, in either a prospectus supplement (the most common method), a post-effective amendment or, where permitted, an Exchange Act report incorporated by reference into the registration statement.

Eligibility Requirements for Filing a Shelf Registration Statement

In order to be eligible to use Form S-3 or Form F-3, among other requirements, the issuer:

- Must have a class of securities registered under the Exchange Act (or must be required to file reports under Section 15(d) of the Exchange Act);
- Must have been subject to the reporting requirements of Section 12 or Section 15(d) of the Exchange Act for at least 12 calendar months immediately preceding the filing of the registration statement and have timely filed all required reports with the SEC during that period; and
- Since the end of the last year covered by its audited financial statements, cannot have failed to pay dividends or sinking fund installments on preferred stock or defaulted on installments on indebtedness for borrowed money or on material leases.

Issuance of Nonconvertible Securities

An issuer is considered "primarily eligible" to use Form S-3 or Form F-3 if the aggregate market value of its voting and non-voting common equity held by non-affiliates (its "public float") is at least $75 million.

As an alternative to the $75 million public float requirement, issuers may use Form S-3 or Form F-3 for offerings of nonconvertible securities (other than common equity), if the issuer satisfies any one of the following criteria:

- The issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least $1 billion in nonconvertible securities, other than common equity, in primary offerings for cash registered under the Securities Act, over the prior three years;
- The issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of nonconvertible securities, other than common equity, issued in primary offerings for cash registered under the Securities Act;
- The issuer is a wholly-owned subsidiary of a well-known seasoned issuer ("WKSI"); or
- The issuer is a majority-owned operating partnership of a real estate investment trust ("REIT") that qualifies as a WKSI.

"Baby Shelf" Issuers

Smaller issuers with a public float of less than $75 million may also be primarily eligible to use Form S-3 or Form F-3 if the issuer:

- Meets the other eligibility requirements of the relevant Form;
- Is not and has not been a "shell company" for at least 12 calendar months prior to the filing of the Form;
- Has a class of common equity securities listed on a national securities exchange (i.e., not the over-the-counter market or the "pink sheets"); and
- Does not sell in a 12-month period more than the equivalent of one-third of its public float (the "one-third cap").

However, an issuer with a public float that does not exceed the $75 million market value threshold may not sell more than the equivalent of one-third of its public float during any 12 consecutive months. The determination of the issuer's public float will be made 60 days prior to the proposed sale.

The aggregate market value of all securities sold during the 12-month period prior to the sale is calculated by using the price of all securities sold by the issuer under the applicable Form in the previous 12 months, whether debt or equity, including those to be sold in the proposed sale. For securities convertible into or exercisable for equity securities ("derivative securities"), issuers will calculate the amount that they may sell in any 12-month period by reference to the market value of the underlying shares as opposed to the market value of the derivative securities. The one-third cap will not impact a holder's ability to convert or exercise derivative securities once a derivative security has been properly issued under the test, even if the issuer's public float decreases.

After all or any portion of the derivative securities are exercised or converted, in order to determine the amount of any securities that may be issued under the one-third cap in addition to any of the derivative securities that remain unexercised, the value of the exercised or converted portion will be calculated by multiplying the number of underlying shares issued by the market price on the date of conversion. Because the calculation of the one-third limitation depends on the issuer's public float at any point in time, an issuer's ability to use its shelf registration statement may increase or decrease during the life of the shelf. Increases to an issuer's public float will increase its "shelf capacity"; decreases to its public float will decrease its "shelf capacity."

Ineligible Issuers

An ineligible issuer is an issuer for which any of the following is true:

- The issuer has not filed all reports required to be filed during the preceding 12 months (or any shorter period for which the issuer has been required to file);
- The issuer is, or during the past three years was, a "blank check company" or a shell company or offered penny stock;
- The issuer is a limited partnership offering securities other than through a firm commitment underwriting;
- The issuer was the subject of a bankruptcy proceeding within the past three years;
- Within the past three years the issuer (or any subsidiary) was convicted of any felony or misdemeanor under Section 15(b)(4)(b) of the Exchange Act;
- Within the past three years the issuer (or any subsidiary) was the subject of any judicial or administrative decree or order arising out of a governmental antifraud action;
- The issuer filed a registration statement that is the subject of any pending proceeding or examination under Section 8 of the Securities Act (which relates to misleading or incomplete registration statements) or was
  the subject of any refusal order or stop order within the past three years; or
- The issuer is the subject of any pending proceeding under Section 8A of the Securities Act in connection with an offering.

The SEC has the power under its rules to determine, upon a showing of good cause, that it is not necessary under certain circumstances for an issuer to be considered an ineligible issuer.

Qualifying as, and the Benefits of Being, a WKSI

Qualifying as a WKSI

In order to qualify as a WKSI, an issuer will be required to file reports with the SEC under Section 13(a) or Section 15(d) of the Exchange Act and satisfy the following requirements:

- It must meet the registrant requirements of Form S-3 or Form F-3 (i.e., it must be a "primarily eligible" issuer);
- It must, as of a date within 60 days of filing its shelf registration statement, either:

- Have a worldwide market value of its outstanding voting and non-voting common stock held by non-affiliates of $700 million or more; or
- Have issued in the last three years at least $1 billion aggregate principal amount of non-convertible securities in registered primary offerings for cash; and

- It must not be an "ineligible issuer."

A majority-owned subsidiary of a WKSI will itself be a WKSI in connection with:

- Its issuance of non-convertible investment grade securities that are fully and unconditionally guaranteed by its parent; or
- Its issuance of guarantees of non-convertible securities of its parent or of another majority-owned subsidiary whose non-convertible securities are so guaranteed by the WKSI parent.

If the majority-owned subsidiary is itself a WKSI by reason of its issuance of $1 billion or more of nonconvertible securities and also meets the test of a primarily eligible issuer, the subsidiary may register an offering of its common stock or other equity securities as a WKSI, filing an automatic shelf registration statement.

Benefits of WKSI Status

A WKSI may take advantage of a more flexible automatic registration process. If a WKSI checks the applicable box on the cover of a registration statement (including a shelf registration statement) on Form S-3 or Form F-3, for either a primary or secondary offering or a combination, the registration statement will automatically be effective upon filing. Therefore there will be no delay in effectiveness.

A WKSI will also have the ability to:

- Register unspecified amounts of different types of securities;
- Register additional classes of securities and eligible majority-owned subsidiaries as additional registrants after effectiveness by filing a post-effective amendment that also will be automatically effective upon filing;
- Exclude additional information from the base prospectus including:
  - Whether the offering is a primary or secondary offering;
  - A description of the securities, other than the name or class of securities (i.e., "debt," "common stock" and "preferred stock");
  - The names of selling security holders and the amounts of securities to be offered by each; and
  - Disclosure regarding the plan of distribution;
- Pay filing fees on a "pay-as-you-go" basis at the time of each takedown; and
- Use "free writing prospectuses" relating to an offering before the registration statement is filed.

Shelf Registration Filing Requirements

An issuer must include the undertakings set forth in Item 512(a)(1) of Regulation S-K in its shelf registration statement filing. These undertakings include the duty to update the prospectus under Section 10(a)(3) of the Securities Act to reflect fundamental changes and changes in the plan of distribution. Issuers also must undertake to deregister any unsold securities at the end of the offering. An issuer must also agree that, consistent with Rule 430B and Rule 430C, information in the prospectus supplement is deemed part of and included in the applicable registration statement as of specified dates (generally the earlier of the date the prospectus supplement is first used or the date of the first contract of sale for securities in the offering described in the prospectus supplement). Further, for liability purposes of the issuer and any underwriter, that date will be deemed the new effective date of the registration statement relating to the securities to which that prospectus supplement relates.

A post-effective amendment is required instead of a prospectus supplement when:

- There is a "fundamental change" (a higher threshold than "material") to the disclosure;
- The disclosure in the registration statement has to be updated for Section 10(a)(3) purposes; or
- There is a change to the plan of distribution (e.g., switching to an "at-the-market" offering from a firm commitment offering).

However, the undertaking to file a post-effective amendment in these instances will not apply if the registration statement is on Form S-3 or Form F-3, and the required information is contained in an Exchange Act report (including a Current Report on Form 8-K) that is incorporated by reference in the registration statement or is contained in a prospectus supplement filed pursuant to Rule 424(b).

In a delayed primary shelf offering, the specific terms of the offering (e.g., price, number of securities, etc.) are usually provided in a prospectus supplement filed under Rule 430A of Regulation C. Accordingly, a post-effective amendment to the registration statement is not needed.

Incorporation by reference occurs when disclosure in one filed document is legally deemed to be included in another document. A Form S-3 or Form F-3 allows a company to incorporate by reference the disclosure from its current and future Exchange Act reports to satisfy the disclosure requirements of the Form.

Limitations on a Shelf Registration Statement

Offerings under Rule 415(a)(1)(x) and continuous offerings under Rule 415(a)(1)(ix) that are registered on Form S-3 or Form F-3 are not subject to the two-year limitation on the amount of securities that can be registered, but a shelf registration statement can only be used for three years (subject to a limited extension) after its initial effective date. Under the current rules, new shelf registration statements must be filed every three years (the three-year period begins on the initial effective date of the shelf registration statement), with unsold securities and fees paid under an "expiring" registration statement rolled over to the new registration statement where it relates to:

- Offerings by WKSIs on an automatic shelf registration; or
- Offerings described in Rule 415(a)(1)(vii), (ix) or (x).

The three-year time limitation was adopted because the SEC believes that the precise contents of shelf registration statements may become difficult to identify over time (since many different documents may be incorporated by reference) and that markets will benefit from a periodic updating and consolidation requirement. The two-year limitation on the amount of securities that may be registered continues to apply to business combination transactions under Rule 415(a)(i)(viii) and continuous offerings under Rule 415(a)(i) and (ix) not registered on Form S-3 or Form F-3.

Some other types of shelf registration statements are not subject to the three-year limitation, including:

- Registration statements to be used only for secondary offerings by selling security holders; and
- Acquisition shelf registration statements.

In the case of shelf registration statements other than automatic shelf registration statements filed by WKSIs, as long as the new shelf registration statement is filed within three years of the original effective date of the old registration statement, the issuer may continue to offer and sell securities from the old registration statement for up to 180 days thereafter until the new registration statement is declared effective. The 180-day extension does not apply to automatic shelf registration statements, which are effective immediately upon filing.

Prior to the effectiveness of the new shelf registration statement, the issuer can amend it to include any securities remaining unsold from the old registration statement. The SEC filing fees attributable to those securities may be rolled over to the new registration statement. In addition, continuous offerings commenced under the old registration statement prior to the end of the three-year period may continue on the old registration statement until the effective date of the new registration statement if these offerings are permitted to be made under the new registration statement.

For WKSIs, as long as the issuer remains a WKSI, the new shelf registration statement will be effective immediately upon filing. The issuer may elect to include on the new registration statement any unsold securities covered by the old registration statement and SEC filing fees paid attributable to those securities.

Shelf Eligibility and Volatile Markets

In order to remain eligible to use a Form S-3 registration statement, neither the issuer nor any of its consolidated or unconsolidated subsidiaries shall have failed to pay any dividend on its preferred stock since the end of the last fiscal year for which audited financial statements are included in the registration. However, if an issuer's board of directors does not declare a dividend on non-cumulative preferred stock, the issuer is not disqualified from using Form S-3 since no liability to pay the dividend arises under the terms of the non-cumulative preferred stock. Conversely, a declared but unpaid dividend on non-cumulative preferred stock would disqualify the issuer from using Form S-3, as would the existence of accrued and unpaid dividends on cumulative preferred stock. The issuer would also be disqualified from using Form S-3 even if it has a history of accumulating such dividends for three quarters before paying them at the end of each year. However, if the cumulative preferred stock was issued as part of a trust preferred financing and the terms of the underlying debt permit the issuer to defer interest payments for a specific time period and such deferral is not considered a default under the financing, then the issuer may correspondingly defer the accrued dividend payment on the cumulative preferred stock without losing its eligibility to use Form S-3.

As a result of the market volatility caused by the COVID-19 pandemic, certain issuers may lose their status as WKSIs following the effective date of their shelf registration statements. As discussed above, an issuer qualifying as a WKSI may typically file an automatic shelf registration statement with the SEC. A WKSI is defined as an issuer that, among other things, as of a determination date, had a public float of at least $700 million. The "determination date" used to assess an issuer's WKSI eligibility may be any date within 60 days before the filing of (i) the shelf registration statement; (ii) the issuer's most recent post-effective amendment to a previously filed shelf registration statement; or (iii) its most recent Annual Report on Form 10-K or Form 20-F (in the event the issuer has not filed a shelf registration statement or a post-effective amendment for 16 months). An issuer does not need to have a $700 million public float at the time its automatic shelf registration statement is filed so long as it did reach such threshold within the 60-day period prior to the filing. A former WKSI will be required to amend its automatic shelf registration statement by filing a post-effective amendment on Form S-3 to convert the automatic shelf registration statement to a regular shelf registration statement. Given that WKSIs also are entitled to other benefits and accommodations, including certain communications-related safe harbors, the issuer should consult closely with counsel.

Permitted Offerings Pursuant to a Shelf Registration Statement

Rule 415 lists the types of permitted shelf offerings, including:

- Resales by selling security holders;
- Immediate, delayed and continuous offerings by an issuer on Form S-3 or Form F-3, including "at-the-market" offerings by the issuer;
- Securities offered and sold under dividend reinvestment and employee benefit plans;
- Securities underlying options, warrants, rights and convertible securities;
- Securities pledged as collateral;
- Depositary shares evidenced by American Depositary Receipts;
- Securities issued in business combinations;
- Mortgage-related and other investment grade asset-backed securities; and
- Offerings that commence promptly and are made on a continuous basis for more than 30 days.

All transactions registered on Form S-4 or Form F-4 are considered continuous offerings under Rule 415. An issuer can use a shelf registration statement for acquisitions. An issuer can use a shelf registration statement for one or more acquisitions, even if the targets are unknown at the time of filing. An issuer may also register securities for future issuance in connection with acquisitions on a delayed basis. These are known as "acquisition shelves." However, an automatically effective shelf registration statement may not be used as an acquisition shelf.

Liability Considerations

Section 11

Rule 430B and Rule 430C codify the SEC's position that the information contained in a prospectus supplement required to be filed under Rule 424, whether in connection with a takedown or otherwise, will be deemed part of and included in the registration statement containing the base prospectus to which the prospectus supplement relates. For prospectus supplements filed other than in connection with a takedown of securities, all information contained therein will be deemed part of and included in the registration statement as of the date the prospectus supplement is first used. For prospectus supplements in connection with takedowns, it is the earlier of the date the supplement is first used or the date and time of the first contract of sale for the securities.

Regulation FD

In some cases, Rule 100(b)(2)(iv) of Regulation FD exempts offerings registered under the Securities Act, except offerings registered under Rule 415(a)(i)-(vi). In the case of an offering under Rule 415(a)(i)-(vi), the issuance and delivery of the registration statement, the prospectus and certain free writing prospectuses will not be deemed a violation of Regulation FD.

In general, ongoing and continuous offerings on behalf of selling security holders will not be exempt from Regulation FD. However, continuous and ongoing offerings on behalf of selling security holders that also involve a registered offering, whether or not underwritten, by the issuer for capital formation purposes will be exempt (because Rule 415(a)(i) pertains to resale transactions "solely on behalf" of selling security holders).

For example, a registered underwritten offering that includes shares issued by the issuer and selling security holders is exempt from Regulation FD, but a registered underwritten offering of only selling security holders' shares is subject to Regulation FD. Accordingly, in the former case, an issuer free writing prospectus can be used without raising any Regulation FD concerns. However, in the latter case, the use of an issuer free writing prospectus must be evaluated in the context of Regulation FD. In adopting Regulation FD, the SEC has expressed its concern that, because registration statements involving only secondary sales are often effective and used for a very long period, an issuer could be effectively exempt from Regulation FD if the exclusion for registered offerings covered them.

Underwriter Due Diligence

Rule 176 under the Securities Act sets forth the factors to determine whether a reasonable investigation or reasonable grounds for belief under Section 11(c) of the Securities Act exist, under which an underwriter's due diligence defense is available. These factors include:

- The type of issuer;
- Reasonable reliance on officers, employees and others whose duties should have given them knowledge of particular facts; and
- With respect to facts or documents incorporated by reference, whether the particular person had any responsibility for the facts or documents at the time of the filing from which it was incorporated.

Checklist of Key Questions

- Is the issuer planning to sell new securities or outstanding securities?
- Are securities being immediately offered after the registration statement becomes effective?
- Will the issuer choose to offer securities in a delayed primary offering?
- Is the issuer considered a well-known seasoned issuer?
- Is the issuer subject to the baby shelf limitation?
- Is the issuer considering using a shelf registration for one or more acquisitions?
- Will the issuer be required to file a post-effective amendment as opposed to a prospectus supplement?

Special Purpose Acquisition Companies ("SPACs")

Here's the deal:

- What is a SPAC?
- Why are SPAC IPOs popular?
- What is the typical capital structure of a SPAC after its IPO and prior to completion of the initial business combination or merger?
- Why should a private operating company consider merging with/into a SPAC?
- Are SPACs blank check companies or shell companies?
- How would this affect the ability of the SPAC to engage in roadshow and other outreach efforts?
- What securities law considerations should operating companies consider when evaluating a merger with a SPAC?
- What are some of the factors considered by the securities exchanges with respect to the number of holders of SPAC common stock and warrants?

What's the Deal?

Special purpose acquisition companies ("SPACs"), commonly referred to as "blank check companies," are public shell companies that use their initial public offering ("IPO") proceeds in order to acquire private companies within a specific timeframe (this acquisition is commonly referred to as an "initial business combination" and the merger or combination transaction is often referred to as the "de-SPACing transaction"). Although SPACs have existed for decades, merging into a SPAC has recently become an attractive alternative for private companies in lieu of undertaking traditional IPOs. Today, SPACs have higher quality sponsors, more blue-chip investors, bulge bracket underwriters, and better sponsor-investor alignment structures than the past. These factors have contributed to making SPACs more mainstream investment vehicles, and have now accounted for approximately 20% of IPO proceeds in 2019 and 38% of IPO proceeds in 2020 year-to-date. SPACs have raised approximately $19 billion through July 2020, which is much higher than 2019's record of approximately $13.5 billion.

How SPACs Work

Not all SPACs are the same. Some SPACs are focused on completing an acquisition in a particular geography or industry, while some have no such mandate. However, SPACs cannot identify specific private companies as targets pre-IPO. Post-IPO, SPACs place 100% of their IPO proceeds in an interestbearing trust account, which is generally accessible only to complete an initial business combination or redeem investors under certain conditions. In order to compensate investors for this illiquidity, SPACs offer investors units, each of which is comprised of common stock and whole or fractional warrants in order to acquire additional common stock in the future. The warrants are typically priced "out of the money," *i.e.*, at a higher price than the IPO offering price of the unit. Shortly following the IPO, the common stock and the warrants trade separately alongside the units.

In general, the sponsor receives 20% of the SPAC's common stock (the "founder's shares") following the SPAC's IPO for nominal consideration as compensation. The founder's shares typically are subject to a lock-up agreement until the initial business combination is completed. The sponsor also purchases warrants to fund the costs associated with the SPAC's IPO, such as underwriting fees, in a private placement occurring in conjunction with the IPO (the "at risk capital"). The nominal consideration used to purchase the founder's shares are held in a trust account. Sponsors typically do not receive management fees until the initial business combination is completed.

As mentioned briefly above, SPACs must use their IPO proceeds in order to acquire private companies, or its "targets", within a specific timeframe, which is typically 18-24 months. Although some SPACs may include an option to extend this deadline (*e.g.*, through a shareholder vote), SPACs must liquidate trust accounts and redeem investors (plus interest) should they fail to acquire a target within the specified timeframes. The founder's shares are not redeemed for cash upon liquidation, which encourages sponsors to find a suitable target.

Once a sponsor identifies a target, the SPAC requires shareholder approval to complete the proposed initial business combination. The SPAC also will offer investors the election either to redeem their common stock for the original purchase price plus interest, or to sell their common stock to the SPAC in a tender offer. Investors may redeem their common stock regardless of a vote for or against the merger, and investors may hold their warrants even if they redeem their common stock. Once a merger is announced, the sponsor will seek to obtain the required approvals for the proposed transaction, and the merger with the target company is generally referred to, as noted above, as "de-SPACing." Following completion of the merger, the operating company is the surviving public company.

Advantages for an Operating Company of Merging into a SPAC

For an operating company, merging with and into a SPAC may be faster than undertaking a traditional IPO; however, this will depend upon the nature of the negotiations between the SPAC and the operating company and the shareholder approval process. An operating company should take into account that merging with a SPAC will require significant management time and resources. The process entails the negotiation of a merger agreement and related ancillary documents, which will be time consuming. In addition, in connection with the solicitation of shareholder approval by the SPAC for the merger transaction, the operating company will be required to prepare disclosures about its business, including risk factors, operating results, and management. Following completion of the SPAC merger, the operating company will be required to comply with public company corporate governance requirements. For a private company, going public through a SPAC merger may provide greater certainty with respect to valuation than undertaking a traditional IPO. The merger consideration (and the valuation for the private company) is set when the merger agreement is executed. Although a repricing may be possible as a result of market volatility or for other reasons.

In connection with the SPAC merger, the SPAC will communicate with its shareholders and with other market participants regarding the merger. Given that these are business combination related discussions and not communications related to an IPO, there may be greater flexibility relating to the content and timing of the communications.

Disadvantages of SPACs

Historically, there has been concern regarding the alignment of interests between SPAC sponsors and SPAC shareholders. Given that sponsors generally receive 20% of a SPAC's common stock for nominal compensation, sponsors may profit even if a future acquisition proves unsuccessful. More recently, there have been some changes in the SPAC structure. Most notably, in the SPAC sponsored by Bill Ackman, the SPAC sponsor will forego all founder's shares.

SPACs also create significant arbitrage opportunities that can impede long-term investing. Traditionally, hedge funds invested in SPACs because SPACs allowed investors to keep their warrants even if they redeemed their common stock. Redemption rights also create inherent uncertainty about the amount of funds available to the SPAC to complete an acquisition. Recently, many SPACs have mitigated this concern by issuing additional equity or equity-linked securities usually contingent upon the merger closing in a private placement or a private investment in public equity ("PIPE") transaction. A capital-raising transaction also may provide additional capital for the operating company to deploy to fund its continued growth.

There is also the possibility that market participants may not like the proposed business combination. Over half of the companies that have emerged from a merger with a SPAC have experienced poor aftermarket performance. Over time, this trend may reverse itself as more SPACs are completed, and the more recent SPACs are larger and led by better known sponsor groups, which may lead to greater long-term success. The operating company also may want to consider how it will establish a relationship with investment banks that will be in a position to provide equity research coverage and make a market in the securities of the operating company following completion of the transaction. While a SPAC will undertake investor outreach in connection with soliciting shareholder approval of the merger transaction, these investor meetings may not be sufficient to develop a familiarity among institutional investors with the operating company. During a traditional IPO process, and perhaps in the private placements preceding many IPOs, the IPO issuer will have an opportunity to meet with and form relationships with institutional investors that are committed to or interested in the IPO issuer's sector. Last, SPACs will incur significant costs.

Securities Law Considerations for SPAC IPOs

Exemption from "Blank-Check Company" Status under Rule 419

SPACs are designed to avoid being classified "blank-check companies" under the securities laws. This is because under Rule 419 under the Securities Act of 1933, as amended (the "Securities Act"), a blank-check company must, among other things, deposit all proceeds and securities issued in its IPO into an escrow account, and there is a prohibition from transferring or trading the securities until after completion of a business combination. Although depositing funds into an escrow account has become market practice for SPACs, it would be a hindrance to restrict trading pending the completion of a business combination (the documentation for most SPACs allows up to 24 months for the SPAC to complete this process). To be deemed a blank-check company, the issuer must issue "penny stock," as defined in Rule 3a51-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Exchange Act Rule 3a51-1(g) excludes from the definition of penny stock any security of an issuer that has been in operation for less than three years and has at least $5 million in net tangible assets. In order to benefit from this exclusion, the SEC requires that the issuer file a Form 8-K with an audited balance sheet as soon as practicable after the IPO demonstrating compliance. Generally, SPACs use the Exchange Act Rule 3a51-1(g) exclusion and avoid Rule 419's requirements.

Typically, a SPAC's IPO registration statement will state that the SPAC will file such a Form 8-K promptly after consummation of the IPO. If an overallotment option is exercised after the filing of this Form 8-K, the SPAC will need to file an additional Form 8-K with an updated audited balance sheet reflecting the overallotment exercise. The underwriting agreement also typically contains covenants that require the SPAC to file the Form 8-K.

SPACs as Shell Companies and Ineligible Issuers

While exempt from Securities Rule 419, a SPAC is considered a "shell company" under Securities Act Rule 405. As a consequence:

- A SPAC is an "ineligible issuer," as defined in Securities Act Rule 405, and thus may not use free writing prospectuses (without the benefit of the free writing prospectus rules, roadshow presentations are subject to additional restrictions, which are discussed below);
- Holders of the SPAC's securities may not rely on Securities Act Rule 144 for resales of such securities until one year after the SPAC has completed its initial business combination and filed current Form 10 information (the SPAC must also have filed periodic reports required by Section 13 or 15(d) of the Exchange Act (other than Form 8-K reports) for the prior 12 months (or such shorter period that the SPAC was required to file such reports));
- A SPAC cannot become a well-known seasoned issuer until three years have passed since its initial business combination; and
- A SPAC cannot use many of the communications safe harbors under the Securities Act.

Investment Company Act

The structure of a SPAC's trust account is designed to avoid the SPAC being classified as an "investment company" under the Investment Company Act of 1940, as amended (the "Investment Company Act").

Following its IPO, a SPAC is typically required to invest the IPO proceeds held in trust in either government securities or in money market funds that invest only in government securities. By doing so, a SPAC may rely on Rule 3a-1 under the Investment Company Act, which excludes companies with no more than 45% of the value of its total assets consisting of, and no more than 45% of the issuer's net income after taxes deriving from, securities (excluding government securities). There are also no-action letters in which the SEC Staff concurs with the view that securities in certain money market funds also can be excluded from these calculations.

Emerging Growth Company

A SPAC may be considered an emerging growth company ("EGC") as defined in Section 2(a)(19) of the Securities Act, and if so it will remain an EGC until the earlier of (i) the last day of the fiscal year (a) following the fifth anniversary of the completion of the IPO, (b) in which the SPAC has a total annual gross revenue of at least $1.07 billion (adjusted for inflation every five years), or (c) in which the market value of its common equity held by non-affiliates exceeds $700 million as of the prior June 30 (or second fiscal quarter end if not a December 31 fiscal year end company) and (ii) the date on which the SPAC has issued more than $1 billion in non-convertible debt securities during the prior three year period. If following its initial business combination, the SPAC (newly deSPAC-ed) continues to qualify as an EGC under these rules, the company will continue to benefit from being an EGC.

Marketing and Offering Related Communications Considerations

Roadshows

Under Securities Act Rule 433 any roadshow that is a "written communication" is a free writing prospectus. As discussed above, SPACs are not able to use free writing prospectuses. Under Securities Act Rule 405 a "communication that, at the time of the communication, originates live, in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means" does not constitute a written communication. A live, real-time roadshow to a live audience will not be considered a written communication, and therefore not a free writing prospectus. This means that for a SPAC IPO:

- Traditional roadshow presentations where the SPAC's management and the underwriters meet in person with prospective investors are acceptable; live telephone conference calls are also permissible;
- A roadshow presentation cannot be recorded; though broadcasts of live, real-time presentations at the time of transmission can be used;
- Roadshow decks may be passed out to meeting attendees but must be collected at the end of the presentation and attendees may not take the slides with them; slides can also be broadcast if they are viewable only during the presentation; and
- Roadshow decks may not be emailed to accounts or transmitted in any way that allows the recipient to keep the deck after the roadshow presentation is over.

Safe Harbor Analysis

As a shell company and an ineligible issuer, SPACs may not rely on the following communications safe harbors:

- Research report safe harbors – Securities Act Rules 137, 138 and 139
- Communications more than 30 days before a registration statement is on file – Securities Act Rule 163A

These restrictions expire three years after the SPAC completes its initial business combination.

A SPAC may rely on Securities Act Rule 134 for communications announcing an offering. Communications that comply with Securities Act Rule 134 are deemed not to be a "prospectus," as defined in Section 2(a)(10) of the Securities Act, or a free writing prospectus.

Additionally, SPACs may rely on the "access equals delivery" rules under the Securities Act.

Testing-the-Waters Communications

Under Section 5(d) of the Securities Act, EGCs and persons authorized to act on their behalf (*e.g.*, underwriters) are permitted to participate in oral or written communications with potential investors that are qualified institutional buyers ("QIBs") under Securities Act Rule 144A or institutions that are accredited investors ("IAIs") under Securities Act Rule 501 to determine if those investors may be interested in a potential securities offering. A SPAC may engage in "testing-the-waters" communications.

Nasdaq Considerations

One of the requirements of a Nasdaq Capital Market ("Nasdaq") listing is that [the] securities are held by at least 300 round lot holders (*i.e.*, holders of at least 100 shares of common stock) and that at least 50% of the 300 required round lot holders must hold unrestricted securities with at least $2,500 in value.

To ensure compliance with this listing requirement, Nasdaq typically requires a letter from the managing underwriter of the IPO to the effect that underwriters intend to sell the listed securities such that, following the IPO, there will be at least 300 round lot holders that are unrestricted securities and at least 50% of such round lot holders will hold unrestricted securities with a market value of at least $2,500.

Furthermore, Nasdaq often requests a list of all round lot holders within 15 days after closing of a SPAC's IPO. In order to provide proper evidence to Nasdaq, the SPAC will have to order non-objecting beneficial holder reports and a share range analysis from Broadridge and Mediant after the closing of the IPO.

Nasdaq's position with respect to accepting a share range analysis, without more detailed information, is as follows:

- If the share range analysis shows 300 round lot holders they will not be satisfied, as they will assume that some of the accounts are owned by the same holder.
- If the share range analysis shows 400 or more round lot holders, that is sufficient.
- If the share range analysis shows more than 300 but fewer than 400 round lot holders, that is a judgment call that the examiner will make.

In the event that Nasdaq is not satisfied, it will request that the underwriters provide more information about the investors that bought in the IPO to confirm that 300 different accounts purchased a sufficient number of securities in the IPO. It is unclear that Nasdaq would require this if the information is not available or there are legal or other restrictions on sharing the information.

In counting round lot holders, Nasdaq will not count as separate accounts those for relatives sharing a household. For this reason, the syndicate must coordinate book-building efforts so that they avoid duplicate investors and avoid the risk of not meeting the minimum 300 round lot holders. Underwriters are advised to aim for a 400 holder count in case there are inadvertent duplicate accounts.

Roles of Financial Intermediaries

The underwriter of a SPAC IPO may have various roles in relation to the SPAC once the SPAC has completed its IPO (*e.g.*, capital markets advisor, private placement agent, and M&A financial advisor). As an initial matter, every potential new role should be scrutinized for conflicts of interest. This is especially important as the underwriter stands to receive a portion of its underwriting discount (typically 35 basis points to be split among the syndicate members) only if the SPAC completes an initial business combination. As a consequence, the underwriter should ensure that the board of directors of the SPAC and, if appropriate, investors are aware of this conflict of interest as the underwriter engages in any of the roles discussed below.

An underwriter of a SPAC IPO may be asked to assist in various capital markets related activities as the SPAC searches for, and completes, its initial business combination target. These may include: (i) wall crossing accounts to discuss their views on a potential qualifying transaction; (ii) arranging meetings with accounts prior to and during the proxy solicitation process; (iii) assisting the SPAC with the preparation of presentation materials. This role is sometimes described as a "capital markets advisor."

Assisting the SPAC in its communications with investors raises potential issues under the proxy solicitation rules and it is important that the capital markets advisor not be viewed as soliciting a proxy since the underwriter, acting as a capital markets advisor, will not have complied with the various rules and regulations applicable to those soliciting a proxy (including the rules contained in Exchange Act Regulation 14A). As a consequence, the capital markets advisor should consider limiting its activities to ministerial functions. In these ministerial communications the underwriter should consider including language disclosing that it stands to collect its deferred compensation should the SPAC complete its initial business combination.

The underwriter of a SPAC IPO may be asked to act as a placement agent in a PIPE, or to underwrite or arrange debt financing, in each case, that may be needed to complete an initial business combination. The underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter, inclusive of an indemnification agreement. The engagement letter should include language disclosing that the underwriter stands to collect its deferred compensation should the SPAC complete its initial business combination. The underwriter should also consider including such language in materials sent to investors.

It is common for a former underwriter of a SPAC IPO to bring potential acquisition opportunities to the SPAC and, where the former underwriter either brings the potential acquisition opportunity to the

SPAC or has relevant sector expertise, to act as financial advisor to the SPAC. If the former underwriter acts as M&A advisor to the SPAC in its initial business combination, the former underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter inclusive of an indemnification agreement. The engagement letter should include language disclosing that the former underwriter stands to collect its deferred compensation should the SPAC complete its initial business combination.

The former underwriter may not want, or the SPAC may not want the former underwriter, to render a fairness opinion with respect to the initial business combination because of the conflict of interest disclosure that would be required in the fairness opinion.

It is less common for a former underwriter of a SPAC IPO to represent the target in an initial business combination. However, depending on the facts and circumstances, the underwriter's fairness committee may be comfortable representing a target and even issuing a fairness opinion (with the appropriate conflict of interest disclosures). This, presumably, would be much more likely where the target is a private company and no public disclosure of the target fairness opinion is required. If the underwriter represents the target in the SPAC's initial business combination, the underwriter should follow its normal practices for an engagement of this type including, if applicable, entering into a separate engagement letter inclusive of an indemnification agreement.

Conclusion

Given that there are more and more well-regarded SPAC sponsors, and that SPACs have become a more mainstream investment vehicle, private companies considering an IPO or a direct listing may also want to consider merging into a SPAC. Nonetheless, as discussed throughout this article, not all SPACs are the same, and some structures are better, more transparent, and less expensive than others. Further, there are distinct securities laws and regulations to consider with respect to SPACs. As a result, private companies should consider all of the advantages and disadvantages above before deciding that a merger with a SPAC is the best option.

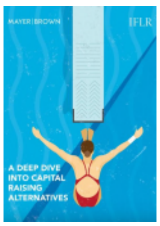
Checklist of Key Questions

- Has the operating company considered an initial public offering?
- Has the operating company undertaken any IPO readiness initiatives?
- Is the operating company prepared for the diligence to be undertaken by the SPAC in connection with the SPAC initial business combination transaction?
- Does the operating company have the necessary risk factor, business and management disclosures and the audited annual and reviewed interim financial statements that will be necessary for the SPAC's proxy statement?
- Has the operating company considered the time and expense required in connection with the negotiation of the initial business combination transaction and the stockholder approval process?
- Do the operating company stockholders understand the consequences, from a securities law perspective, of being a former shell company (former SPAC) and how these will affect the company's ability to raise capital or to provide liquidity opportunities to stockholders?

Free Writings & Perspectives

Our blog, *Free Writings & Perspectives*, provides up-to-the-minute news regarding securities law developments, particularly related to capital formation, as well as commentary regarding developments affecting private placements, late stage private placements, PIPEs, IPOs and the IPO market, and new financial products. Visit http://www.freewritings.law.

A Deep Dive Into Capital Raising Alternatives



Published by the *International Financial Law Review,* A Deep Dive into Capital Raising Alternatives provides an overview of the Jumpstart Our Business Startups (JOBS) Act, including the IPO on-ramp provisions, Regulation A, Regulation Crowdfunding, the changes to the Securities Exchange Act of 1934 threshold for US Securities and Exchange Commission (SEC) reporting, and the changes eliminating the prohibition against general solicitation in connection with certain exempt offerings.

The book provides context on the changes in market structure and market dynamics that led to the enactment of the JOBS Act. Specifically, the trend for many private companies to remain private longer, defer or dispense with traditional IPOs in the United States, and rely on private capital to fund their growth. The book also offers some insights into alternative approaches to becoming a public company, including direct listings and merging into SPACs. Visit http://bit.ly/3d2sSVA.

Structuring Liability Management Transactions

Structuring Liability Management Transactions, published by the *International Financial Law Review,* provides a summary of the US legal framework, including guidance provided in numerous no-action letters issued over many years, applicable to debt repurchases, tender offers and exchange offers. The Mayer Brown authors also present some of the main regulatory and tax considerations that should be taken into account when determining the best approach. Visit https://bit.ly/3me9qre.

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