As privately held companies choose to remain private longer and defer their initial public offerings or other liquidity opportunities, these companies are focused on raising capital in private placements made principally to institutional investors, cross-over funds and strategic investors. Late stage private placements have almost become a prerequisite to an IPO, or perhaps they are the new IPOs.

**U.S. LATE STAGE FINANCINGS**

- **Capital Raised**: $44.9 billion
  - 2015: $28.9 million (avg. deal size)
  - 2014: $21.7 million (avg. deal size)
- **No. of Deals Completed**: 1,548 Deals
  - 2015
  - 1,862 Deals
  - 2014

**Volume by Sector in 2015**

- SOFTWARE: 36%
- HEALTHCARE: 11%
- COMMERCIAL SERVICES: 10%
- PHARMA/BIOTECH: 6%
- CONSUMER: 4%
- MEDIA: 4%
- IT HARDWARE: 3%
- ENERGY: 2%
- OTHER SECTORS: 23%

In the technology sector, there were 712 late stage deals completed, which raised $27.6 billion.

In the biotech sector, there were 106 late stage deals completed, which raised $3.3 billion.

**Unicorns**

"Unicorns" are private companies valued at $1 billion and above.

As of April 2016 there were a total of 93 Unicorns in the United States valued at over $326 billion.

For more information about late stage financings, visit: [http://www.mofo.com/practices/services/business-finance/capital-markets/late-stage-investments](http://www.mofo.com/practices/services/business-finance/capital-markets/late-stage-investments)

"Late Stage" references Series B through Series Z+ rounds.

Sources: Pitchbook, CB Insights

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What are “PIPEs”? A PIPE (Private Investment in Public Equity) refers to any private placement of securities of an already-public company that is made to selected accredited investors (usually to selected institutional accredited investors). In a typical PIPE transaction, investors enter into a purchase agreement that commits them to purchase securities and usually requires the issuer to file a resale registration statement covering the resale from time to time of the privately purchased securities.

Number of PIPE Transactions

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>1116</td>
<td>1099</td>
<td>1177</td>
<td>1097</td>
</tr>
</tbody>
</table>

Dollars Raised in PIPE Transactions

- 2015: $57.0 billion
- 2014: $34.6 billion
- 2013: $23.8 billion
- 2012: $36.1 billion

Instruments Issued in PIPE Transactions in 2015

- Common stock: 61.80%
- Convertible debt: 14.77%
- Convertible preferred stock: 11.12%
- Equity line: 6.93%
- Prepaid warrant: 2.55%
- Non-convertible debt: 2.46%
- Other: convertible: 0.18%
- Non-convertible preferred stock: 0.09%
- Unknown: 0.09%

No. of PIPE Transactions By Market Capitalization

- Less than $50M: 156
- $50M-$99M: 31
- $100M-$249M: 44
- $250M-$499M: 32
- $500M-999M: 15
- $1B-4.9B: 21
- Greater than $5B: 8

Top Five Most Active Sectors

- Biotech: 14.9%
- Pharmaceuticals & Related: 11.5%
- Energy: Oil & Gas: 7.4%
- Metals, Minerals & Stones: 6.1%
- Healthcare: Medical Equipment: 5.6%

The information provided herein does not constitute legal advice, and should not be acted upon; always obtain specific legal advice based on particular situations. The views expressed herein shall not be attributed to Morrison & Foerster, its attorneys or clients.

Data Source: PrivateRaise

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For more information on PIPE transactions, see our FAQs on PIPEs: http://media.mofo.com/files/Uploads/Images/FAQsPIPEs.pdf
FREQUENTLY ASKED QUESTIONS
ABOUTPIPES

Understanding PIPEs

What are “PIPEs”?
A PIPE (Private Investment in Public Equity) refers to any private placement of securities of an already-public company that is made to selected accredited investors (usually to selected institutional accredited investors). See “How is ‘accredited investor’ defined?” In a typical PIPE transaction, investors enter into a purchase agreement that commits them to purchase securities and usually requires the issuer to file a resale registration statement covering the resale from time to time of the privately purchased securities.

Equity lines of credit are not PIPE transactions. See “What is an equity line of credit?” below.

Are all public companies permitted to engage in PIPE transactions, or are there eligibility requirements?
Yes, all public companies that are reporting companies may engage in PIPE transactions. See Requirements for an Issuer below.

Is there a limit to the number of purchasers that may participate in a PIPE transaction?
If all of the offerees are accredited investors, there is no limit on the number of offerees or purchasers that may participate in a PIPE transaction. See “How is ‘accredited investor’ defined?” below. However, to the extent that the issuer and the placement agent intend to rely on the exemption from the registration requirements under Section 4(a)(2) of the Securities Act of 1933, as amended (the “Securities Act”) and the Rule 506(b) safe harbor, the placement agent must take care not to engage in any marketing or sales activity that would constitute a “general solicitation.”

How is “accredited investor” defined?
Rule 501 promulgated under Regulation D of the Securities Act sets forth the definition of an “accredited investor.” The definition was updated following the passage of the Dodd-Frank Act.

What kinds of securities are sold in PIPE transactions?
PIPE transactions may involve the sale of common stock, convertible preferred stock, convertible debentures, warrants, or other equity or equity-like securities of an already-public company.

There are a number of common types of PIPE transactions, including:

• the sale of common stock at a fixed price;
• the sale of common stock at a fixed price, together with fixed price warrants;
• the sale of common stock at a fixed price, together with resettable or variable priced warrants;
• the sale of common stock at a variable price;
• the sale of convertible preferred stock or convertible debt;
• a change of control transaction; and
• a venture-style private placement for an already-public company.

What are some of the advantages of a PIPE transaction?

A PIPE transaction offers several significant advantages for an issuer, including:

• transaction expenses that are lower than the expenses that an issuer would incur in connection with a public offering;
• the issuer will expand its base of accredited and institutional investors;
• for fixed price transactions, investors will have less incentive to hedge their commitment by shorting the issuer’s stock;
• the transaction will be disclosed to the public only after definitive purchase commitments are received from investors;
• investors receive only very streamlined offering materials or information, including publicly filed Exchange Act reports; and
• a transaction can close and fund within seven to ten days of receiving definitive purchase commitments.

Some of the advantages for an investor include receiving a discount to the current market price (in order to compensate for the initial resale restrictions) and, once the SEC declares the resale registration statement effective, having unrestricted, freely tradeable securities.

What are some of the weaknesses of a PIPE transaction?

PIPE transactions have a few disadvantages for issuers, including:

• investors will require a discount to market on the purchase price (in order to compensate for the initial resale restrictions);
• there will be a limit on the number of “black-out” periods for the issuer while the resale registration statement is effective (see “What is a ‘black-out’ period?” below);
• as a general matter, the offering can only be marketed to accredited investors (see “How is ‘accredited investor’ defined?”); and
• an issuer cannot sell more than 20% of its outstanding stock at a discount without receiving prior stockholder approval. See “Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?” below.

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Traditional PIPE Transactions

What is a traditional PIPE transaction?

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.
Investors in a traditional PIPE transaction commit to purchase a specified number of shares at a fixed price, and the issuer commits to filing a resale registration statement covering the resale from time to time of the purchased shares. The closing is conditioned upon, among other things, the SEC’s preparedness to declare that resale registration statement effective.

**What is a “black-out” period?**

In connection with a PIPE transaction, an issuer typically must keep a resale registration statement effective for an agreed-upon length of time so that the securities may be sold freely, without reliance on Rule 144. 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. A black-out period also may be referred to as a “suspension period.”

**How do traditional PIPE transactions differ from non-traditional PIPE transactions?**

In a traditional PIPE transaction, investors enter into a definitive purchase agreement with the issuer in which they commit to purchase securities at a fixed price. Thus, the investor bears the price risk from the time of pricing until the time of closing—a period ranging from three to thirty days, depending on the SEC’s review of the resale registration statement. The issuer is not obligated to deliver additional securities to the PIPE investors if the stock price fluctuates (or for any other reason).

Investors in a traditional PIPE do not fund when they enter into a purchase agreement. Instead, the issuer then files a resale registration statement covering the resale from time to time of those securities by the PIPE investors. The transaction closes once the SEC indicates its preparedness to declare the resale registration statement effective. Consequently, investors in a traditional PIPE transaction have a resale registration statement available at the time of closing.

Non-traditional transactions generally are structured as private placements with follow-on (or trailing) registration rights. This means that a closing is scheduled when investors enter into a definitive purchase agreement. Investors fund and the transaction closes. Post-closing, the issuer has an obligation to file a resale registration statement and use its best efforts to have it declared effective.

Typically, the purchase agreement or a separate registration rights agreement outlines specific deadlines for the issuer to file, and then to seek effectiveness of, the resale registration statement. Some PIPE transactions require the issuer to make penalty payments for failure to meet those deadlines.

In the case of a PIPE structured as a private placement with follow-on registration rights, the investor will not have the benefit of a resale registration statement for some time—usually 45 to 90 days following the closing. During that period, investors will hold restricted securities.
What are the standard terms of a traditional PIPE transaction?

A traditional PIPE transaction generally involves the following features:

- private placement to selected accredited investors;
- investors irrevocably commit to purchase a fixed number of securities at a fixed price, not subject to market price adjustments or to fluctuating ratios;
- purchase agreements generally contain a limitation on black-out periods;
- immediately following execution of purchase agreements with investors, the issuer files a resale registration statement covering resales from time to time of the restricted securities to be sold in the transaction, naming the purchasers as “Selling Stockholders”;
- closing of the PIPE transaction occurs promptly upon notice of the SEC’s willingness to declare the resale registration statement effective; and
- the resale registration statement is effective until shares may be sold free of restrictions under Rule 144.

Does the placement agent or a lead investor control the process in a traditional PIPE transaction?

In a traditional PIPE transaction, the process is controlled by the placement agent, rather than by a lead investor. The placement agent conducts its own business and financial due diligence.

Do investors conduct their own due diligence in a PIPE transaction?

Investors generally limit their diligence investigation to discussions with management and the company’s independent auditors. Traditional PIPE purchasers generally do not negotiate for themselves ongoing negative covenants or covenants relating to information rights or corporate governance.

When does the PIPE purchaser in a traditional PIPE transaction pay for the securities?

No money is exchanged when the purchase agreement is executed. Purchasers pay the purchase price only when they are informed that the resale registration statement is ready to be declared effective.

What are the other closing conditions for a traditional PIPE transaction?

A traditional PIPE transaction generally involves the following closing conditions:

- 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 have been 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.
Purchasers will receive legended securities at the closing. However, a purchaser can receive clean (unlegended) securities—either at the closing or afterwards—by delivering to the issuer’s transfer agent a certificate (in contemplation of transferring or otherwise disposing of the shares) acknowledging that the purchaser recognizes its obligation to deliver a prospectus to any prospective purchaser of the shares and making certain representations concerning future sales of the shares.

Typically, the resale registration statement is declared effective on the day of (but subsequent to) the closing or on the following business day.

**How does a traditional PIPE transaction settle?**

A traditional PIPE transaction settles outside of the DTC ( Depository Trust Company) system. Investors receive actual physical stock certificates representing the securities. The issuer works with its transfer agent to make arrangements for the closing of the transaction.

**What are the benefits of traditional PIPE transactions compared to non-traditional PIPE transactions?**

By comparison to a non-traditional PIPE transaction, which is structured as a private placement with follow-on registration rights, a traditional PIPE transaction involves less uncertainty, market risk, and illiquidity.

Purchasers in a traditional PIPE transaction are not required to close until a resale registration statement is available for subsequent sales of the purchased shares. Traditional PIPE purchasers can obtain unlegended shares at, or shortly after, closing, which allows them flexibility in disposing of the shares.

For most registered investment funds, securities purchased in a traditional PIPE transaction are counted in the funds’ public basket.

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**Non-traditional PIPE Transactions**

**What are the standard terms of non-traditional (or structured) PIPE transactions?**

A non-traditional (or structured) PIPE transaction generally involves the following features:

- a private placement to selected accredited investors;
- investors commit to purchase securities at a fixed price or at a variable/reset price;
- for transactions involving variable/reset pricing, the purchase agreement generally contains specific pricing parameters, which may include a cap on the maximum number of shares that may be issued to the PIPE purchasers;
- the purchase agreement generally contains a limitation on black-out periods;
- the transaction closes and funds promptly after investors execute purchase agreements;
- the issuer files a resale registration statement covering resales from time to time of the restricted securities sold in the PIPE transaction, naming the purchasers as “Selling Stockholders”;
- the issuer may be obligated to make penalty payments if it fails to file the registration statement within an allotted period, or if the issuer fails to use its best efforts to have the
registration statement declared effective within a defined period; and

- the resale registration statement is kept effective until shares may be sold freely under Rule 144.

**When does the purchaser pay for the securities in a non-traditional PIPE transaction?**

In a non-traditional PIPE transaction, the purchaser pays for the securities at the closing, which takes place promptly after the execution of all of the applicable purchase agreements. Purchasers pay for and receive restricted securities bearing a Securities Act legend. Unlike purchasers in a traditional PIPE transaction, purchasers in a non-traditional PIPE transaction will not have the immediate benefit of an effective resale registration statement.

**What are other closing conditions and covenants in non-traditional PIPE transactions?**

A non-traditional PIPE transaction generally involves the following closing conditions:

- the purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement), which will be brought down at closing;
- for variable/reset 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 have been no material adverse change since execution of the purchase agreement.

**Do purchasers receive restricted (legended) securities at closing?**

Yes. At the closing of a non-traditional PIPE transaction, purchasers receive legended securities.

Typically, purchasers will hold these restricted securities for a period of 45 to 90 days (or longer) following the closing. During this period, the issuer will file the resale registration statement with the SEC and seek to have it declared effective. If the issuer fails to meet any of the deadlines for filing or effectiveness outlined in the purchase agreement, the issuer may be required to make penalty payments to the purchasers.

Purchasers have limited liquidity while the resale registration statement is pending. Once the resale registration statement is declared effective, the purchasers can sell their securities pursuant to the resale registration statement, although they will be required to deliver their legended stock certificates and a legal opinion to the transfer agent in advance of any trade. This process often results in significant delays.
Is a registered direct transaction a PIPE?

Although some of the features of a registered direct offering (i.e., sales to selected institutional investors by a placement agent) give it the appearance of a private placement, a registered direct offering is a public offering. The offered securities 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.

Pricing and Other Negotiating Points of PIPE Transactions

Will purchasers agree to purchase securities at a fixed price or a variable price?

PIPE transactions may be fixed price or variable/reset price transactions.

Variable/reset price transactions often include price protection. For example, investors seek “downside protection” by negotiating rights for themselves that protect the value of their investment in the event of a downward price fluctuation. Conversely, issuers may negotiate a “cap” or “floor” to limit their exposure with respect to the maximum number of shares that may be issued as a result of stock price fluctuations or other conditions.

How is the price set?

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.

Typically, PIPEs are priced at a modest discount to the closing bid price for the stock to compensate for the temporary illiquidity of the purchased shares. Often, in variable/reset transactions, the price is set based on a formula that relates to the average closing price of the stock over several days preceding the pricing.

Who bears price risk?

In a fixed price transaction, the purchaser bears the price risk during the period from execution of the purchase agreement until the closing.

In a variable/reset price transaction, the price risk is shared between the investor and the issuer. Usually, the investor will negotiate some price protection for itself.

What are the other frequent negotiating points in PIPE transactions?

In addition to negotiating specific carve-outs for representations and warranties, the placement agent, purchaser, and issuer typically negotiate the following points:

- whether issuer’s counsel will include a 10b-5 negative assurance in its opinion;
- whether the issuer will be required to cause its independent auditor to furnish the placement agent (if any) with a comfort letter at closing;
- whether there will be a limitation on the length and number of black-out periods;
- whether there will be a time limit for filing the resale registration statement following execution of the purchase agreements;
- the length of time given to the issuer to have the resale registration statement declared effective (most often 60 days); and
• whether there will be penalty payments tied to the filing and effectiveness of the resale registration statement.

Sharing Transaction Details with Potential Investors

Who may participate in PIPE transactions?
Accredited investors are eligible to participate in PIPE transactions. Funds, including mutual funds, pension funds, and hedge funds, are frequent PIPE purchasers. More recently, distressed funds and venture funds have begun participating in PIPE transactions. Distressed funds and venture funds typically negotiate additional covenants in their purchase agreements relating to corporate governance rights and information rights.

What information do investors receive?
All investors in a PIPE transaction receive the same information: a private placement memorandum containing the issuer’s Exchange Act documents. Investors generally do not receive projections or other information that has not been disclosed publicly.

Should investors sign a confidentiality agreement?
Because investors do not receive material nonpublic information, it may not be necessary for them to sign a general confidentiality agreement. However, the issuer will be sharing information (the fact that the issuer is considering a financing transaction) that is not known to the market. Thus, the placement agent and the issuer should obtain from each prospective investor an oral or written agreement stating that the investor will keep information relating to the potential offering confidential and acknowledging that the investor understands how confidential information must be treated under the securities laws. Any such agreement should contain an express agreement to refrain from trading in the issuer’s securities. See “Regulation FD and other Legal Concerns.” Given an already-public company’s desire to keep information about a potential financing in the form of a PIPE transaction confidential until such time as a definitive agreement is executed, it would be inconsistent for the issuer and/or the placement agent to use general solicitation in connection with a possible transaction.

Will investors know what a PIPE transaction is?
There are many misconceptions about PIPE transactions, but typically, within each institution, there is a compliance or legal person who is familiar with the PIPE structure.

PIPE transactions have received negative press in the past. How does the market view PIPEs today?
In the past, PIPEs have been confused with death spiral transactions and equity lines of credit. See “What is a death spiral or toxic convert?” and “What is an equity line of credit?” below. Unlike PIPEs, these transactions can result in ongoing and substantial dilution. Also, the SEC’s enforcement division has brought a number of actions against hedge funds and other investors in PIPE transactions that traded in advance of the public announcement of the transaction while in possession of material nonpublic information or that engaged in manipulative trading practices in connection with PIPE transactions.

PIPE deals have grown in popularity over the past few years. The types of issuers taking advantage of the PIPE structure has broadened from small companies to New York Stock Exchange traded companies. In addition, the numerous publications, websites, and conferences
that cover the PIPE market have made the PIPE structure more familiar to investors.

**Requirements for an Issuer**

**What kinds of issuers finance through PIPE transactions?**

Historically, PIPE transactions have been used by issuers with significant capital requirements, including life science and biotech companies, real estate investment trusts, and technology companies.

In recent years, as the volume of PIPE transactions has increased, the variety of issuers coming to market with PIPE transactions also has increased. PIPE issuers now range in size and include larger, more established companies. These issuers usually view PIPE transactions as an alternative to shelf takedowns, traditional follow-on offerings, or bought deals. In addition, many issuers use PIPE transactions to provide liquidity to existing stockholders. In some instances, where a shelf takedown may not be possible, such as in connection with financing an acquisition, a PIPE transaction may be the only choice.

**What are an issuer’s typical considerations relating to a PIPE transaction?**

In evaluating a PIPE transaction as a possible financing option and in considering a PIPE transaction versus other potential financing options, an issuer should generally consider the following:

- usually the issuer cannot issue more than 20% of its total shares outstanding at a discount in the PIPE transaction without shareholder approval and prior notification to exchanges (see “Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?”) below;
- the purchaser (not the issuer) bears market risk;
- the transaction can close quickly, provided there is no SEC review;
- the format is familiar to sophisticated institutional investors;
- PIPEs typically involve a modest discount to market price;
- the SEC is comfortable with the PIPE format; and
- PIPEs do not have any of the negative effects associated with a “death spiral,” preferred stock offering, or an equity line of credit. See “What is a death spiral or toxic convert?” and “What is an equity line of credit?” below.

**Must an issuer be eligible to use a Form S-3 registration statement on a primary basis in order to complete a PIPE transaction?**

Issuers need not be Form S-3 eligible on a primary basis in order to complete a PIPE transaction, but must be eligible to use Form S-3 on a resale basis. An 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, but using a Form S-3 is cheaper and less time-consuming than using a Form S-1. The Form S-3 is less burdensome and may be updated by the periodic filing of Exchange Act reports, without the need to file post-effective amendments.
**What are the eligibility requirements for use of a Form S-3 registration statement for resales?**

In order to use Form S-3 for resales (secondary shares):

1. An issuer must:
   - be organized, and have its principal business operations, in the United States or one of its territories;
   - 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
   - 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 unconsolidated 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:
   - (1) have failed to make any required dividend or sinking fund payment on preferred stock or (2) 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.

**May an issuer use an existing shelf registration statement to complete a PIPE transaction?**

Generally, if an issuer has a shelf registration statement on file, it is a primary shelf registration statement covering the sale by the issuer of its newly issued securities. An issuer may have a shelf registration statement on file that includes primary (issuer) shares and secondary (selling stockholder) shares. In that case, the issuer may be able to use that registration statement for a PIPE and name the PIPE purchasers as the “selling stockholders.” Generally, though, 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.

**Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?**

A PIPE transaction may require prior approval from the exchange on which the issuer’s common stock is quoted if the transaction will be completed at a discount and may result in the issuance of 20% or more of the issuer’s total shares outstanding. 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. Each of the New York Stock Exchange, the NYSE MKT, and Nasdaq has a similar requirement.

A New York Stock Exchange-listed company must comply with Rule 312.03(c), which requires that the issuer obtain 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: (1) 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; or (2) the number of shares of common stock to be issued is, or will be upon issuance, equal to, or in excess of, 20% of the number of shares of common stock outstanding before the issuance of the common 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 private financing for cash, at a price at least as great as each of the book and market value of the issuer’s common stock.

Section 713 of the NYSE MKT 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 price less than the greater of book or market value 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 less than the greater of book or market value of the stock.

Rule 5635 of the Nasdaq Marketplace Rules requires that an issuer obtain shareholder approval in connection with a transaction other than a public offering, involving: (1) the sale, issuance or potential issuance by the issuer, at a price less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) that, together with sales by officers, directors or substantial shareholders of the company, equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or (2) the sale, issuance, or potential issuance by the company, for less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance.

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.

**Regulation FD and Other Legal Concerns**

*How does an issuer ensure that it has complied with Regulation FD in the context of conducting a PIPE transaction?*

An issuer is owed a duty of confidence from its agents, such as its placement agent, accountants, and other participants in the PIPE process. Generally, an issuer does not share any information with potential investors that has not already been included in the issuer’s Exchange Act reports.

A private placement memorandum for a PIPE transaction usually contains the issuer’s Exchange Act reports, together with legal disclaimers. It is prudent to limit the information contained in the private placement memorandum unless the issuer will be receiving signed confidentiality agreements. Although the issuer is not sharing material nonpublic information about its business with potential PIPE investors, the issuer is sharing its plans concerning a potential financing transaction. The fact that the issuer is contemplating a
PIPE transaction may itself constitute material nonpublic information. This will depend on the particular facts and circumstances. In any event, however, an issuer will not want to be forced to make a premature disclosure regarding a financing.

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 agreement contains an explicit undertaking on the part of the potential purchaser to refrain from trading in the issuer’s stock.

Given that an issuer that is contemplating 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.

What must the placement agent do in order to comply with Regulation M?

Most PIPE transactions are “distributions” for purposes of Regulation M. The placement agent must refrain from making a market in the issuer’s securities during the applicable Regulation M “restricted period.” Depending on the average daily trading volume of the issuer’s security, the restricted period for an agent participating in a PIPE transaction is either one or five days prior to the pricing (as opposed to the funding or closing of the transaction). The placement agent also must file a Regulation M notice with FINRA.

What are the sources of the “primary” versus “secondary” offering questions that some issuers have received in connection with resale registration statements that have been reviewed?

Certain issuers that have filed resale registration statements to cover the resale of shares originally offered in a PIPE transaction have received comments from the SEC questioning whether it is appropriate for the issuer to use a resale registration statement (rather than a primary registration statement) for those shares, particularly in the case of PIPE transactions involving convertible securities. This is especially the case for small cap issuers, as well as for issuers that have sold a disproportionately large number of shares in a PIPE, which has been understood to mean shares in excess of 33% of the total shares outstanding prior to the PIPE transaction.

In these cases, the SEC will take a look at the facts and circumstances of the issuance and the resale registration statement. The SEC will look at the factors it outlined in its 1997 interpretative guidance. Specifically, the SEC will consider: the amount of securities involved; how long the securities have been held; whether the investors are at market risk from the time they purchase the securities; the circumstances under which the securities were acquired; and whether it appears the seller is acting as a conduit for the issuer. Of course, to the extent the SEC is comfortable that the private placement was properly completed, the issuer can proceed with the use of the resale registration statement.

The SEC has said that in instances where it will not permit the resale registration statement to proceed, the issuer can cut back the number of shares and then file a
second resale registration statement for the shares that were cut back.

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**Equity Lines of Credit, “Future-Priced” Securities, and Death Spiral or Toxic Converts**

**What is an equity line of credit?**

Under an equity line of credit, the company enters into an agency 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.

**What is a “future priced” security?**

Future priced securities are convertible securities, often issued through a private placement or in a Regulation S offering. For example, death spiral or toxic converts are “future priced” securities. See “What is a death spiral or toxic convert?”

The conversion price or conversion ratio of the security is tied to a percentage discount to the market price of the underlying common stock at the time of conversion. As a result, the conversion price floats, or varies, based on the market price of the underlying common stock. The lower the market price at the time of conversion, the greater the number of underlying shares that will be issued upon conversion.

**What is a death spiral or toxic convert?**

The terms death spiral or toxic convert refer to a privately placed convertible security that has a floating conversion ratio, without a “floor.” The conversion ratio of the security adjusts based upon the market price of the company’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) 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. Generally, the securities are placed by a hedge fund, instead of a broker-dealer. These securities may have very dilutive effects on the company’s stock.

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Background

What is a registered direct offering?
A registered direct offering is a public offering that is sold by a placement agent on an agency, or best efforts, basis (rather than a firm commitment underwriting). See “About the Placement Agent.” A registered direct offering is marketed and sold much like a PIPE (private investment in public equity) transaction to a selected number of accredited and institutional investors. However, since registered direct offerings are fully registered transactions, shares in those offerings can be sold to anyone. Because they can be marketed like PIPE offerings, registered direct offerings often are referred to as “registered PIPEs.”

What are some of the advantages of a registered direct offering?
Issuers and placement agents often favor registered direct offerings because registered direct offerings are marketed to a targeted group of investors like private placements or PIPEs. Issuers that want to test the market or conduct an offering without attracting publicity find that a registered direct offering is a good choice. Moreover, given the targeted marketing of a registered direct offering, the issuer’s stock usually does not become exposed to the speculative trading that often accompanies a fully marketed follow-on offering.

When an issuer has an effective shelf registration statement, the placement agent may market a potential registered direct offering as it would a PIPE transaction—by obtaining confidentiality undertakings until such time as an actual transaction is announced. This permits an issuer to “test” the market for a potential offering, without a public announcement that might affect the issuer’s stock price. The issuer would announce the transaction immediately prior to pricing or at pricing.

An issuer that is deciding between a PIPE transaction and a registered direct offering may choose a registered direct offering for pricing reasons. Specifically, a PIPE offering will be subject to some liquidity discount that will not affect a registered public offering. See “Are the shares sold in a registered direct offering freely tradeable?”

Now that more issuers are eligible to use a Form S-3 registration statement, more are likely to consider a registered direct offering as a financing option.
What are some of the disadvantages of a registered direct offering?

First, as noted above, an advantage of a registered direct offering is that it is marketed in a targeted manner. However, that may mean that the offering is not as widely distributed as any other public offering.

Second, an issuer in a registered direct offering may have problems under the rules of its securities exchange. If an issuer anticipates offering and selling a number of shares that exceeds 20% of the total shares outstanding prior to the offering, and those shares will be sold at a discount, the offering may not be considered a “public offering” under the rules of the applicable exchange. Certain securities exchanges will consider whether an offering is an underwritten (a firm commitment) offering and will consider the nature of the marketing process in determining whether an offering is a “public offering.” If a registered direct offering is not considered a “public offering” by a securities exchange, that is a problem because the securities exchanges have regulations that require an issuer to obtain shareholder approval before completing a “private placement” at discount to the greater of book or market value and that results in the issuance of shares that equal 20% or more of the number of total shares outstanding prior to the offering. In the case of a registered direct offering, this is typically a facts and circumstances question. The analysis considers factors such as the number of offerees and the means in which the offering was marketed. An issuer may address this concern in a number of ways. First, an issuer may choose to limit the offering size. Second, an issuer may decide to offer shares of common stock and warrants in a “market” offering, not at a discount. Third, the issuer and the placement agent may decide to convert the transaction to an underwritten offering.

Documentation

Does an issuer need a shelf registration statement to conduct a registered direct offering?

An issuer can file a registration statement for the express purpose of conducting a registered direct offering (known as a “bullet” registration statement), or the issuer can use an existing shelf registration statement to conduct a registered direct offering as a shelf takedown.

How does the documentation differ in a registered direct offering?

**Bullet:** An issuer that does not have an effective shelf registration statement must file a registration statement with the SEC. The issuer can choose a single purpose registration statement (a “bullet”) or a shelf registration statement.

Once a registration statement has been cleared with the SEC, the issuer and the placement agent agree to conduct a registered direct offering and enter into a placement agency agreement. Under a placement agency agreement, the placement agent agrees to use its best efforts to introduce the issuer to investors. See “About the Placement Agent.”

The issuer prepares and files a prospectus (or prospectus supplement) that describes the offering, and investors purchase the securities directly from the issuer.

**Takedown:** If the issuer already has an effective shelf registration statement, it may choose to conduct a takedown off the shelf registration statement as a registered direct offering. Depending on the manner in which the offering is marketed and sold, the issuer will prepare a preliminary prospectus supplement or a final prospectus supplement that describes the offering. The
placement agent and the issuer also will enter into a placement agency agreement, as described above.

**What is the placement agency agreement?**

The placement agency agreement is the principal agreement between the issuer and the placement agent, and is the equivalent of an underwriting agreement in a firm commitment underwritten offering. In the placement agency agreement, the issuer:

- agrees to retain the placement agent on an exclusive basis to introduce to it on a best efforts basis investors that may purchase the offered securities;
- makes representations and warranties (similar to those in an underwriting agreement) about itself and its business;
- agrees to certain covenants; and
- agrees to indemnify the placement agent and certain of its affiliates from Securities Act liabilities arising in connection with the offering.

The placement agency agreement also requires as closing conditions that the issuer deliver to the placement agent legal opinions, including an opinion of the issuer’s counsel addressed to the placement agent that provides a 10b-5 negative assurance. The agreement also requires that the issuer’s independent accountants deliver a comfort letter addressed to the placement agent. The issuer also is required to deliver other customary closing certificates.

The agreement does not require the placement agent to purchase any of the offered securities. See “About the Placement Agent.”

**Do investors sign any documents or complete a purchase agreement?**

Unlike in a PIPE transaction, where there are individual purchase agreements, a registered direct offering generally does not involve individual purchase agreements between the issuer and the purchasers. Occasionally, hedge fund purchasers in registered direct transactions ask the issuer to execute an agreement making representations and warranties to the purchasers that are similar to those made to the placement agent in the placement agency agreement.

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**Offering Details**

**Are there different kinds or formats of registered direct offerings?**

In a registered direct offering, the issuer can offer and sell any security—common stock, preferred stock, or debt securities. A registered direct offering may be structured in one of three ways:

- as an “any-or-all” transaction, wherein the transaction will close regardless of how many securities are sold or the amount of proceeds raised;
- as a “minimum-maximum” transaction, where a certain minimum threshold dollar amount must be raised in order for the transaction to close and a maximum offering size also is indicated; or
- as an “all-or-none” transaction, where all of the securities offered must be sold in order for the transaction to close.
When must an escrow account be used?
In the case of either a minimum-maximum offering or an all-or-none offering, the placement agent must set up an escrow account to collect and hold the investor funds until the conditions for release are met. See Rule 15c2-4 under the Securities Exchange Act. In the case of a registered direct offering that is conducted on an any-or-all basis, there is no requirement to use an escrow arrangement.

What do investors receive in a registered direct offering?
Investors may receive marketing materials, including a free writing prospectus or a preliminary prospectus or preliminary prospectus supplement. Prior to closing, investors will receive a confirmation or statement showing the number of securities that have been allocated to their account and other closing and account wiring instructions.

Does a registered direct offering settle and close like a private placement or like a public offering?
A registered direct offering is a public offering and the shares sold are issued through the Depository Trust Corporation’s book-entry system as electronic book entries and not as physical stock certificates. (In contrast, shares issued in PIPE transactions take the form of physical stock certificates.). Registered direct offerings, like firm commitment public offerings, close on a T + 3 or T + 4 basis.

Generally, the issuer will work with the placement agent on closing mechanics. The securities may be released by the issuer through its transfer agent to the placement agent’s DTC account for delivery to the investors. Alternatively, the issuer and transfer agent may deliver the securities to the investors through the DTC DWAC system.

Are the shares sold in a registered direct offering freely tradeable?
Yes. The shares sold in a registered direct offering are freely tradable, fully registered shares sold pursuant to a registration statement. As a result, the shares may be transferred freely. In contrast, shares sold in a PIPE transaction are restricted securities that bear a legend indicating that the shares were sold in a private placement.

Could a registered direct offering be used to sell primary (issuer) and secondary (selling stockholder) shares?
Yes. An issuer may sell its own newly issued shares in a registered direct offering. A selling stockholder also may use a registered direct offering to sell its shares—either alone or with primary (issuer) shares.

May a registered direct offering include an over-allotment option?
A registered direct offering does not include an over-allotment option. An over-allotment option relates principally to stabilizing in connection with a firm commitment offering and is not applicable to a best efforts agency deal like a registered direct offering. A placement agent will not engage in stabilizing transactions. An issuer can increase the size of the offering to meet additional demand.

About the Placement Agent

Does a placement agent need to use its regulatory capital in connection with a registered direct offering?
No. In a registered direct offering, a placement agent is not obligated to purchase any shares that are offered. As a result, a placement agent does not need to use its capital.
**Does Regulation M apply to placement agents in a registered direct offering?**

Yes. A registered direct offering is a “distribution” for Regulation M purposes. The trading restrictions of Regulation M apply to the placement agent in a registered direct offering. This means that the placement agent should pay particular attention to the applicable restricted period for the issuer’s securities and should take care to make the required Regulation M filings with FINRA.

**Can a placement agent engage in market making in connection with a registered direct offering?**

A placement agent cannot engage in market stabilizing transactions in a best efforts agency transaction like a registered direct offering. A placement agent can engage only in passive market making activities.

**Is the placement agent in a registered direct offering considered an “underwriter”?**

A placement agent in a registered direct offering is acting as a distribution participant and likely would be considered a statutory underwriter from a securities law perspective as it is introducing new securities into the market. However, in a registered direct offering, the placement agent does not take possession of the offered securities. The placement agent is simply intermediating the sale. Also, in a registered direct offering, a majority of the securities are sold to institutional investors, as opposed to retail investors, which, as a practical matter, may have the effect of minimizing the potential for actions by investors against the placement agent.
FREQUENTLY ASKED QUESTIONS
ABOUT BOUGHT DEALS AND BLOCK TRADES

Bought Deals

What is a “bought deal”?  
In a typical underwritten offering of securities, the underwriters will engage in a confidential (in the case of a wall-crossed or pre-marketed offering) and/or a public marketing period (which may be quite abbreviated) to build a “book” and price the offering of securities. In a traditional underwritten offering, the underwriters will have an opportunity to market the offering and obtain indications of interest from investors before the underwriters enter into the underwriting agreement with the issuer.

By contrast, in a “bought deal” (sometimes also referred to as an “overnight deal”), the issuer usually will establish a competitive “bid” process and solicit bids from multiple underwriters familiar with the issuer and its business. The bidding underwriters will be given a short period of time in which to bid a price at which they are willing to purchase the issuer’s securities. A bidder in a bought deal will not have had an opportunity to conduct any marketing effort before it provides the bid price and agrees to enter into a firm commitment to purchase the securities from the issuer. The securities will be issued in a registered public offering and may be offered by the issuer (primary shares) and/or selling stockholder(s) (often affiliate(s)) of the issuer (secondary shares). The bought deal process will be substantially the same in either case.

Given that the underwriters must agree to a price in advance of conducting any marketing, a bought deal entails significant principal risk. As a result, underwriters in bought deals will negotiate a significant discount, to offset the risk when purchasing the securities from the issuer or selling stockholder(s). Underwriters also may form a syndicate for a bought deal so that each firm bears only a portion of the risk.

What happens if the underwriters do not sell the securities?  
If the underwriters cannot sell the securities, they must hold them and sell them over time. This is usually the result of the market price of the securities falling below their public offering price, resulting in the underwriters losing money. Furthermore, having to hold the securities will often also use up a portion or all of the underwriters’ available regulatory capital, which could probably otherwise be put to better use, as most underwriters are not typically in the business of purchasing new issues of securities.
If an underwriter does not sell the securities and holds them in a proprietary account, it will not be limited to the passive market making allowed under Section 103 of Regulation M. However, it may be subject to further prospectus delivery requirements along with potential liability under Section 11 of the Securities Act of 1933, as amended (the “Securities Act”), upon the resale of such securities.

**Why would an issuer choose to pursue a bought deal over a typical underwritten offering?**

An issuer may choose a bought deal because it can be accomplished quickly. The issuer does not publicly announce its intention to offer securities until it receives a definitive commitment from the underwriters to purchase the securities. As a result, in a bought deal, there is little possibility for investor front-running and, as a result, an issuer may believe that it will obtain better pricing. An issuer may prefer a bought deal over a confidentially marketed public offering because it may not be inclined to bear price risk and may need certainty of execution. However, the issuer typically will be asked to accept a significant discount to the prevailing closing price of its securities in a bought deal, and bought deals generally are only feasible for issuers that are well-known seasoned issuers (“WKSI”), as defined in Rule 405 under the Securities Act, with highly liquid stocks. Otherwise, underwriters likely will not feel comfortable quoting a fixed price.

Bidding underwriters may be somewhat aggressive in bidding, but, given the risks, the bidding underwriters will still bid at a discount to the prevailing market price for the stock in order to mitigate their execution risk.

**What does an issuer need to do in order to execute a bought deal?**

Generally, in order to execute a bought deal, an issuer must have an effective shelf registration statement. If the issuer does not have an effective shelf registration statement, it may still be able to execute a bought deal, provided that it is a WKSI, since a WKSI can file an immediately effective automatic shelf registration statement on Form S-3 without review by the Staff of the Securities and Exchange Commission (the “SEC”). Non-WKSI issuers without an effective shelf registration statement, by contrast, will not be in a position to consider a registered bought deal because they will not typically have the time to wait for a new Form S-3 registration statement to become effective. However, an unregistered Rule 144A-type offering might be executed as a bought deal, although this option usually will be considered only by foreign (non-U.S.) issuers. For more information, see our Frequently Asked Questions About Shelf Offerings, available at:


Next, the issuer must ensure that it has sufficient capacity under its shelf registration statement to execute the bought deal. Again, qualifying as a WKSI here will prove convenient as a WKSI does not need to specify an aggregate dollar amount or number of securities when filing a shelf registration statement, as a WKSI can rely on the “pay-as-you-go” provisions of Rules 456(b) and 457(r) under the Securities Act to pay fees at the time the final prospectus supplement for the offering is filed under Rule 424(b) under the Securities Act. Even if the WKSI shelf registration statement specifies a maximum deal size and there is insufficient remaining capacity, a WKSI can simply file a new, immediately effective
An issuer that is not a WKSI but is still Form S-3 eligible can upsize its existing shelf registration statement if there is insufficient capacity using the immediately effective short-form registration statement pursuant to Rule 462(b) under the Securities Act. However, this option can only be used once per shelf registration statement and also is limited to 20% of the unused capacity of the original shelf registration statement.

An issuer should prepare, with the assistance of counsel, a prospectus supplement (to the base prospectus included in the shelf registration statement) that can be shared with bidding underwriters. Counsel will work with the issuer to ensure that the issuer’s public disclosures are current and that no updating of risk factors or other information is necessary in connection with the proposed offering. The issuer also will need to contact its auditors in advance so that the auditors are well aware of the issuer’s plans and can be in a position to deliver a comfort letter to the underwriters at pricing. Execution will be simplified if the issuer has designated underwriters’ counsel. Designated underwriters’ counsel may be contacted in advance by the issuer and its counsel in advance of any contact being made with the potential underwriters so that designated underwriters’ counsel can update its due diligence and work with the issuer and its counsel on the underwriting agreement, the prospectus supplement and the comfort letter.

*Can a bought deal be executed if no registration statement is available?*

While most bought deals are conducted on a registered basis using an effective shelf registration statement, it is possible for U.S. issuers to execute a bought deal on an exempt basis when an effective registration statement is not available. The mechanics of the bought deal will generally remain the same. Due to the nature of the exempt offering, the universe of available purchasers for an exempt bought deal will be limited to accredited investors (for Regulation D private placements), qualified institutional buyers (for Rule 144A offerings), and “non-U.S. persons” (for Regulation S offerings). Furthermore, as with any other unregistered offering, the securities will be “restricted securities” subject to restrictions on transfers and resales. This may force the issuer to provide a bigger discount due to the lack of liquidity.

*Are there times when it is easier to execute a bought deal?*

Generally, it is easier to undertake a bought deal immediately or shortly after an issuer’s earnings announcement and the filing of its latest quarterly report on Form 10-Q or annual report on Form 10-K in order to coincide with a trading window in the issuer’s insider trading policy (in the case of a secondary trade), and to avoid the need to update disclosure prior to launch, as the issuer’s disclosures will be current. Waiting until the issuer’s earnings announcements and the filing of the Forms 10-K or 10-Q will also make it easier for the underwriters to conduct due diligence and for the underwriters to obtain a comfort letter from the issuer’s auditors.

*Can a bought deal be executed for secondary shares?*

Yes, a bought deal may be executed for secondary shares. A selling stockholder with a substantial position may choose to liquidate its position through a bought deal in order to quickly sell, mitigate its risk and obtain a set price. Also, a significant stockholder, such as a
financial or private equity sponsor, may want to dispense with its position through an underwritten offering as the other liquidity alternatives may not be completed as quickly and may provide less certainty. If a bought deal for secondary shares is conducted on a registered basis, the shelf registration statement must generally allow for sales by selling stockholders and specific disclosure regarding the selling stockholders can be included in a prospectus supplement.

**Documentation for Bought Deals**

**What is included in an issuer’s bid package?**

When contacting potential underwriters to solicit bids for a bought deal, an issuer will provide a bid letter specifying the terms of the transaction and specifying the deadline for bid submissions. An issuer also will provide:

- a copy of the proposed underwriting agreement;
- a draft of the comfort letter from the issuer’s auditors (or assurance that a comfort letter in the customary form will be provided); and
- a draft of the prospectus supplement.

The bid package may also include a current investor presentation, as well as a “launch” press release. Along with the bid package, the issuer should reassure the bidding underwriters that it is not providing or sharing any material non-public information with the underwriters (other than the fact that the issuer may undertake a bought deal).

**What documents are used to execute a bought deal?**

The documentation for a bought deal is very similar to that used in any underwritten offering. The issuer and/or the selling stockholder(s), as applicable, will enter into an underwriting agreement with the underwriters. As discussed above, due to the accelerated timing of a bought deal, the issuer must have an effective shelf registration statement. The issuer and its counsel will prepare a preliminary prospectus supplement and a launch press release. After launch, the press release will be filed or furnished on Form 8-K. After the transaction prices, the final prospectus supplement will be filed as well, and the underwriting agreement will be filed as an exhibit to a Form 8-K.

In connection with the offering, the underwriters will receive a standard comfort letter from the issuer’s auditors, standard legal opinions from issuer’s (and, if applicable, selling stockholders’) counsel, and a 10b-5 negative assurance letter from issuer’s counsel and from underwriters’ counsel. If the selling stockholders are affiliates, they will often provide to the underwriters a representation letter to the effect that the selling stockholders are not in possession of any material non-public information that they are using to make their decision to execute the bought deal.

In a variable price re-offer transaction, there are a few specialized changes to the documentation that underwriters should keep in mind. First, the cover page of the preliminary prospectus supplement will not be set up to disclose the gross proceeds of the offering, minus the underwriters’ discounts and commissions. The table that is included in the prospectus supplement for a typical underwritten offering to show these amounts both on an aggregate and per-share basis is
omitted. Instead, the issuer generally discloses (1) the per share price due to it from the underwriters, and (2) the fact that the underwriters will re-offer the securities to the market at a range of varying prices. A longer explanation of variable price re-offer also is included in the underwriting section of the prospectus supplement.

If the underwriters convey final pricing terms in writing when they confirm final orders (through what is often referred to as a “Rule 134 release”), then that release should also disclose the variable price nature of the transaction and the highest clearing price to the market. The transaction will typically close like most transactions, on a T+3 or T+4 basis.

As soon as an underwriter becomes aware of the potential offering and decides to submit a bid to the issuer, then that underwriter should commence its due diligence. The issuer will make its management available for a standard business due diligence call, and the auditors make themselves available for an auditors’ due diligence call. Designated underwriters’ counsel will have conducted periodic legal due diligence or may be in the midst of conducting their legal due diligence. Underwriters’ counsel generally will undertake standard “shelf” or periodic due diligence, which typically consists of reviewing the issuer’s public filings, reviewing exhibits to the public filings, reviewing press releases, determining whether there have been any changes to the issuer’s ratings, conducting a due diligence call covering regulatory and litigation matters with the issuer or its counsel, and reviewing minutes and other corporate documents.

**Due Diligence for Bought Deals**

**How is due diligence conducted in a bought deal?**

A bought deal is subject to the same disclosure and liability concerns as any traditional underwritten offering. Therefore, despite the time pressure imposed on the offering process, the issuer and the underwriters will need to ensure the accuracy and completeness of the disclosure prior to pricing the offering.

Generally, underwriters will only participate in bought deals for issuers with which they are (as an institution) quite familiar. The underwriters may provide research coverage on the issuer, may have participated in prior offerings by the issuer, or may have conducted non-deal road shows for the issuer. This familiarity will be essential in order for the underwriters to participate in the process and complete their due diligence quickly and efficiently.

**What materials should a bidding underwriter review?**

A bidding underwriter should review carefully all of the materials in the bid package, and should consult with either designated underwriters’ counsel or, if counsel is not designated, issuer’s counsel, to verify that the underwriting agreement is in customary form, that there are no exceptions or qualifications in the comfort letter, and that issuer’s counsel and designated underwriter’s counsel both will provide standard legal opinions and 10b-5 negative assurance letters. The bidding underwriter will also want to confirm that the issuer’s public disclosures are current.
Do bought deals entail any marketing before launch?

It depends. In the conventional bought deal, the issuer will set out the bid process, the bidders will submit their information, business and accounting due diligence calls will take place, and the winning underwriters will be chosen. Promptly thereafter, the issuer and the underwriters will sign the underwriting agreement.

Sometimes, the underwriters may conclude that better execution requires some measure of pre-marketing. In this case, the issuer and the underwriters will agree that the underwriters can conduct limited pre-marketing to investors that have been “wall-crossed.” There are various ways in which the underwriters can gauge the market to determine whether certain investors will participate in the offering. If the underwriters do not wish to restrict investors with whom they speak, they can take a no-names approach, and just talk to investors about securities of an issuer in a particular industry or sector having a certain market capitalization. There will be no specific references made to the issuer of the specific deal the underwriters have bought or intend to buy.

If the underwriters wish to obtain a more concrete indication of interest from investors about the particular bought deal, the underwriters will have to “wall-cross” the investor. If the investor agrees to be taken “over the wall,” the underwriters will send the investor an email confirming its willingness to keep any information conveyed strictly confidential and the investor will be required to send a return email acknowledging the confidentiality agreement. In some cases, formal confidentiality agreements or non-disclosure agreements may be signed for the benefit of the issuer and the underwriters.

The length of this pre-marketing period may vary. Once the issuer has chosen the underwriters, it may agree that the underwriters may reach out to investors for a few hours prior to the issuance of the launch press release. The underwriters should follow their typical approach for wall-crossing investors.

How is a bought deal launched?

A bought deal usually will be announced promptly after market close through the issuance of a launch press release. The launch press release is intended to comply with Rule 134 under the Securities Act. Rule 134 enables an issuer with an effective registration statement to issue a press release that includes certain limited information related to an offering without the communication being deemed to be a prospectus or an issuer free writing prospectus. This Rule 134 release also simultaneously satisfies the requirements of Regulation FD, which requires an issuer to publicly disclose any material, non-public information simultaneously with its intentional disclosure to the financial community at large. A bought deal may or may not on its own constitute a material development. An issuer would be wise to satisfy Regulation FD with a press release, particularly one concurrently filed on a current report on Form 8-K, rather than assume that the bought deal is not material.

Sometimes an issuer will use an issuer free writing prospectus under Rule 433 under the Securities Act to launch a bought deal, though this is less common. The issuer should ensure that whatever approach taken properly conveys all of the information required to be disclosed to investors under the federal securities laws.
The issuer and the underwriters may agree to use a preliminary prospectus supplement (to the base prospectus included in the shelf registration statement). A preliminary prospectus supplement is not required, but it may be useful in order to convey recent developments or provide new or additional information about the issuer. The preliminary prospectus supplement will not contain pricing information; however, it may state whether the offering is structured as a fixed-price deal or a variable re-offer deal. The preliminary prospectus supplement must be filed within 48 hours of first use.

After the launch of the transaction, it remains critical to maintain the confidentiality of the price the underwriters have agreed to pay the issuer and/or selling stockholder(s) for the securities. If an investor obtains this price information, the investor might attempt to extract better pricing from the underwriting syndicate, which may affect deal execution. For this reason, the price paid by the underwriters should not appear in any press release at launch or in the preliminary prospectus supplement.

We may sell the securities covered by this prospectus in any of three ways (or in any combination): (1) to or through underwriters or dealers; (2) directly to one or more purchasers; or (3) through agents.

We may distribute the securities covered by this prospectus from time to time in one or more transactions: (1) at a fixed price or prices, which may be changed from time to time; (2) at market prices prevailing at the time of sale; (3) at prices related to the prevailing market prices; or (4) at negotiated prices.

In a fixed-price offering, the underwriters purchase the shares from the issuer and re-offer the securities to the public at one fixed price, also referred to as a “clearing price.” While the underwriters expect to sell the entire offering at the fixed-price, the plan of distribution for the offering will often contain language allowing the underwriters to change the pricing at any time without notice, in case the underwriters find themselves with securities they cannot sell at the clearing price. This situation, where the underwriters expect to encounter difficulties selling all of the securities, is often referred to as a “sticky deal.”

What is a fixed-price offering?

When filing its shelf registration statement, it is impossible for an issuer to know the exact method of distribution that will be used by underwriters in future takedowns. Therefore, the issuer should include broad language in the base prospectus (included in the shelf registration statement) so that at the time of a takedown there will be no need to update this information. Issuers typically use the following language for this purpose:

We may sell the securities covered by this prospectus in any of three ways (or in any combination): (1) to or through underwriters or dealers; (2) directly to one or more purchasers; or (3) through agents.

What is a variable price re-offer?

In a variable price re-offer, the issuer discloses that the underwriters may vary the price at which the securities are offered to the public and sell the securities, from time to time, in various types of transactions. In a variable price re-offer, there is no announcement at pricing of a single price paid to the issuer because the underwriters may still be “long” the securities at that point.
The underwriters may vary the price at which they offer the securities, take the securities into a proprietary account (unlikely), or place them in managed accounts. Because of the proprietary risk taken by the underwriters, these transactions present significant deal and pricing risk for underwriters. Pre-announcement, it is important that precautionary measures are taken to prevent information leaks that can lead to shorting activity and harm the transaction. Participants should be advised and reminded of their obligations to keep matters confidential.

**Are there any restrictions on the issuer once the bought deal is launched?**

Typically, in order to assist the underwriters in distributing the securities they purchased in the bought deal, the issuer, along with certain company insiders and any selling stockholder(s), will agree not to sell any of the issuer’s securities for a certain period of time after the offering, usually ranging from 30 to 90 days.

**When is pricing information for a bought deal disclosed to the public?**

After the end of the overnight (or otherwise agreed-upon) marketing period, underwriters often will express confidence that they have allocated the entire block of securities to investors (or close to it), in which case the issuer will be eager to announce the “pricing” of the transaction. However, announcement of pricing should not be made until investor orders have been confirmed (after which the underwriters’ risk is greatly reduced).

**How is pricing information shared with the public?**

Issuers are not specifically required by rule to publicly announce the results of an offering prior to filing the final prospectus supplement. However, there may be Regulation FD concerns if the clearing price is known only to a limited number of market participants. Including the clearing price in a pricing press release will address any Regulation FD concerns.

Furthermore, the New York Stock Exchange (the “NYSE”) requires a pricing press release if certain of the pricing terms are considered to be material information. Therefore, an issuer should issue a pricing press release to ensure that the NYSE does not raise issues after the fact.

Underwriters often will want to withhold pricing information as long as possible, particularly if they have not yet sold their entire position. If an issuer presses to disclose the proceeds of the offering, a compromise may be reached by including in a pricing press release the amount of gross proceeds before deducting underwriting discounts and commissions and offering expenses. This amount would be calculated based on the closing trading price on the launch date and the number of shares sold, but would not inform the market of the price paid by the underwriters.

Counsel generally will take the view that the underwriting discounts and commissions and the fixed price are not in and of themselves material, and that the issuer has shared with the market all of the information that may be deemed material (e.g., the size of the deal, the prospective terms of the offering).

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1 Section 202.05 of the NYSE’s Listed Company Manual states:

“A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.”

However, the NYSE usually leaves the ultimate determination of materiality with the company itself.
certainty regarding the deal, timing of the deal, and, possibly, gross proceeds).

**When will the final prospectus supplement be filed?**

While in a typical underwritten offering, the final prospectus supplement is filed within a day of pricing, in a bought deal, the filing of the final prospectus supplement usually is delayed as long as possible. The final prospectus supplement must be filed within two business days of first use, in which case the deal team will have 48 hours during which the market may still be unaware of the pricing details.

In the case of a variable price re-offer, the final prospectus supplement also will contain the amount paid by the underwriters, and filing also may be delayed (in this case, it should be filed within two business days of the pricing of the offering, but not before).

**Who is likely to pursue a block trade?**

An issuer may sell its securities through a block trade; however, that is an unlikely and uncommon scenario. Institutional investors, including mutual funds and pension funds, often execute block trades, while individual investors usually do not. Block trades also are typically used by financial or private equity sponsors, venture capitalists, and other large stockholders who may have acquired large quantities of securities in an M&A or other transaction and wish to sell down their position.

An investment bank may execute a block trade on an agency or best efforts basis, or on a principal basis. Often an affiliate of the issuer may choose to sell securities through a block trade as it may not be able to meet the requirements of Rule 144 under the Securities Act (“Rule 144”) for the public resale of its securities (e.g., one-year holding period, volume limitation, etc.). Unlike Rule 144, there is no volume limitation or prohibition on soliciting buyers applicable to a block trade, making it an enticing option for an affiliate that cannot use Rule 144 for resales.

**Why would one pursue a block trade?**

A block trade offers certain advantages to the selling stockholder. Many securities exchanges permit large block trades to be privately negotiated and transacted off-exchange. Upon being reported to the relevant exchange, the transaction becomes centrally cleared, and the parties to the transaction no longer have to worry about other parties affecting the trade. A block trade also allows a party with a desire to engage in a large-sized transaction to access a different and often larger investor base than regular electronic trading. In addition, block trades are often cheaper than standard

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**Block Trades**

**What is a block trade?**

A block trade is defined as an order or trade submitted for sale or purchase of a large quantity of securities: generally 10,000 shares or more (not including penny stocks) or a total market value of $200,000 or more in bonds. The shares “traded” may be restricted securities or control shares, or may be sold off of an effective shelf registration statement. Certain types of block trades need to be reported to the Financial Industry Regulatory Authority, Inc. (“FINRA”) and the securities exchanges. For more information, see our Frequently Asked Questions About Block Trade Reporting Requirements.
underwritten transactions, and are fast and effective for smaller amounts of stock than are typically offered in an underwritten transaction.

"Distributions" for Block Trade Purposes

Are block trades considered to be "distributions" under the securities laws?

Block trades that are considered “distributions” under the securities laws must be reported under the trade reporting rules of FINRA and could subject the broker-dealer executing the trade to liability as a statutory underwriter under the Securities Act.

Section 2(a)(11) of the Securities Act defines an underwriter as “any person who offers or sells for an issuer in connection with the distribution of any security.” For purposes of this definition, the SEC has defined “issuer” broadly to include any person directly or indirectly controlling or controlled by the issuer or under common control with the issuer. As a result, activities undertaken by a broker-dealer on behalf of affiliates of an issuer (e.g., officers, directors and 5% stockholders) may raise the same concerns as those taken on behalf of the issuer. Furthermore, one does not need to be engaged formally as an underwriter or placement agent in order to incur this potential liability. The broker-dealer’s relationship to the transaction, the extent of its activities and its fees determine whether it may be considered to be acting as a statutory underwriter.

While this broad definition of an “underwriter” is fact-specific, the SEC has routinely refused to make determinations on specific cases, explaining that the individual or entity in question is in a better position than the SEC to determine its status. In addition, the SEC has not included definitions in the Securities Act for certain of the other terms used in Section 2(a)(11), particularly, the term “distribution.” It is clear that only when a “distribution” occurs can an underwriter be involved.

Generally, the marketing and related activities surrounding a block trade may not rise to the level generally associated with a “distribution” under the federal securities laws. The shares purchased and sold often are placed quickly for a standard dealers’ fee, without the use of sales documents and with little sales effort by the broker-dealer. Further, these shares also often are sold to relatively few institutional buyers who already may have expressed an interest in obtaining stock. However, under certain circumstances, block trades may be considered a “distribution,” which has the effect of exposing the broker-dealer to potential liability as an underwriter.

The nature of the party for whom the broker-dealer is executing the block trade may effect whether the transaction is deemed a “distribution” of securities for an issuer. A “distribution” may include a private transaction as well as a public (pursuant to a registration statement) transaction. As used in the Securities Act, an “issuer” is defined to include the issuer itself and its affiliates or control persons. In executing a block trade on behalf of an issuer or on behalf of an affiliate, a broker-dealer should consider the factors discussed below and may wish to structure its activities in a manner intended not to constitute a “distribution.” However, if a broker-dealer is executing a block trade on behalf of a third party (unrelated to the issuer and not an affiliate or control person), depending on the facts and circumstances, it may be more likely...
than not that the transaction is not deemed to constitute a “distribution.”

**Does Regulation M provide any helpful guidance?**

Regulation M, adopted by the SEC to curtail manipulative practices by distribution participants, provides some guidance for determining whether a “distribution” exists. This guidance helps narrow the broad scope of the definition of an underwriter by limiting the situations in which that definition is implicated.

Regulation M defines a “distribution” as “an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.” This definition sets forth two criteria to consider in determining whether activities give rise to a distribution: (1) the magnitude of the offering and (2) whether special selling efforts and selling methods are used in connection with the offering. Presumably, if these factors are absent, the transaction would be considered an ordinary trading transaction and not a “distribution.”

**How does the magnitude of an offering help determine whether a “distribution” exists?**

In determining the magnitude of an offering, the SEC looks to:

- the number of shares being registered or sold;
- the percentage that these shares represent of the total outstanding shares of that issuer;
- the issuer’s public float; and
- the average trading volume of the issuer’s securities.

All of these factors must be taken in context and it is important to note that what may be a problematic fact pattern for one issuer may not raise concerns with respect to another issuer.

**What are “special selling efforts” that a trading desk may use in executing block trades?**

Activities that may constitute special selling efforts and selling methods might include a broker-dealer receiving higher compensation than it ordinarily would receive for normal trading transactions (or dealer activity), the use by such broker-dealer of sales documents, conducting a road show in connection with the transaction, or holding investor meetings. Presumably, if these factors are absent, the transaction would be considered an ordinary trading transaction and not a “distribution.”

The definition of a “distribution,” because it is based on facts and circumstances, can lead to the same facts being considered a “distribution” in one case but not in another. Certain activities may constitute special selling efforts or methods for one broker-dealer while for another larger, established broker-dealer with an active block trading desk, such activities may be in keeping with its regular trading activities. For this reason, a broker-dealer must analyze each situation not only on its merits, but also in the context of the broker-dealer’s regular activities.
executing the block trade on an agency or best efforts basis, it may want a sales agency agreement or, in certain cases, an underwriting agreement. This is less common in cases where the broker-dealer is executing the block trade on a principal basis. The underwriting or sales agency agreement will contain certain stripped-down representations from the seller (including as to valid title, no encumbrances and compliance with securities laws). The underwriting or sales agency agreement also will contain pricing and settlement provisions and will likely contain an indemnity from the seller to the broker-dealer.

If the block trade is considered a “distribution” for purposes of the federal securities laws, then the broker-dealer will want to have a due diligence defense available to it to offset its potential liability as an underwriter. If that is the case, then the broker-dealer will need time to review the issuer’s public disclosures and may ask the issuer to provide it with other materials it wishes to review.

Sometimes law firms will be asked to provide legal opinions, usually covering the seller’s corporate authority, authority to sell the securities and valid title to the securities. A broker-dealer also may request a no-registration opinion, confirming that the block trade does not need to be registered with the SEC. In addition, investors in the block trade may be asked to sign representation letters acknowledging, among other things, the absence of offering documents, their financial sophistication and any selling restrictions applicable to the securities.

If the broker-dealer engages in marketing efforts for the block trade, then it may become necessary for the issuer to issue a press release to satisfy Regulation FD requirements if the trade is considered material, or if some market participants have been provided information that others may not have.

**Is there any marketing period for a block trade?**

No. Generally there is no marketing for block trades, as these trades are not usually considered “distributions” and are not typically underwritten deals. Furthermore, there is no traditional “road show” for a block trade and any selling efforts would be targeted directly at a few institutional investors. However, the disclosure obligations for sales made through block trades are just as rigorous as they would be in any typical underwritten offering and the potential for liability exists in block trades as well.

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**Block Trades and the Section 4(a)(1½) Exemption**

**What is the Section 4(a)(1½) exemption?**

The Section 4(a)(1½) exemption provides a specific exemption for the private resale of restricted or control securities, and can be used to execute block trades. The Section 4(a)(1½) exemption is useful for and popular with investors because it permits the private sale of restricted or control securities without having to rely on the exemption from registration provided under Rule 144. Under Rule 144, a non-affiliate investor would have to satisfy a six-month holding period and an affiliate investor would have to satisfy a one-year holding period and would be subject to certain volume limitations and manner of sale requirements. However, the Section 4(a)(1½) exemption does not impose such holding period requirements, volume limitations or manner of sale requirements.

The Section 4(a)(1½) exemption is a hybrid exemption consisting of:
• the exemption under Section 4(a)(1) of the Securities Act ("Section 4(a)(1)"), which exempts transactions by anyone other than an "issuer, underwriter, or dealer," and

• the analysis under Section 4(a)(2) of the Securities Act ("Section 4(a)(2)") to determine whether the seller is an "underwriter" (in other words, whether the seller purchased the securities with a view towards a "distribution").

Note that the exemption from registration under Section 4(a)(1) is not available because it applies solely to open market or public transactions by individual security holders who hold neither restricted securities or control securities. The exemption from registration under Section 4(a)(2) is not available because it only applies to transactions by an issuer not involving a public offering (and not a selling stockholder).

In 1980, the SEC recognized the Section 4(a)(1½) exemption, which, although not specifically provided for in the Securities Act, clearly was within the intended purpose of the Securities Act, provided that the established criteria for sales under both Section 4(a)(1) and Section 4(a)(2) are satisfied. However, the SEC has since declined to provide further guidance through no-action letter relief.

**What types of investors can use the Section 4(a)(1½) exemption?**

Section 4(a)(1½) offerings can be used by a variety of investors. The Section 4(a)(1½) exemption can be used by institutional investors (typically sponsors, venture capitalists and other large securityholders, who acquired their securities in connection with M&A transactions) to resell their restricted securities or control securities. The Section 4(a)(1½) exemption also can be used by affiliates to sell control securities when the exemption under Rule 144 is not available. In addition, the Section 4(a)(1½) exemption can be used for resales to accredited investors.

**How are sales utilizing the Section 4(a)(1½) exemption structured?**

In a Section 4(a)(1½) transaction (1) the seller must sell in a “private” offering to an investor that satisfies the qualifications of an investor in a Section 4(a)(2) private offering, and (2) the investor must agree to be subject to the same restrictions imposed on the seller in relation to the securities (for example, receiving securities with a restricted legend), in order to demonstrate that the seller is not making the sale with a view towards distribution. However, the investor would still be able to “tack” the holding period of the seller for purposes of satisfying the holding period requirement under Rule 144, if the investor chooses to use the exemption from registration under Rule 144 for a subsequent sale of the securities.

If a purchaser buys securities in a private placement with the intent to resell the securities or serve as a conduit from the issuer to other buyers, Section 4(a)(2) would be violated, and the purchaser will be deemed to have acted as an underwriter. If this occurs, the offering

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3 An investor in a Section 4(a)(2) offering must meet the qualifications laid out by the U.S. Supreme Court in SEC v. *Ralston Purina*, 346 U.S. 119 (1953). Under *Ralston Purina*, purchasers must (1) be sophisticated and (2) have access to the same information as would be available if the securities were registered.
may be deemed a public offering. Deeming the offering to be public would require the issuer to register the offering of the securities with the SEC and each and every state into which it sold its securities.

Section 4(a)(1½) offerings are often structured in the form of a block trade, where the seller engages a financial intermediary to help sell the securities as agent. Because the Section 4(a)(1½) exemption seeks to recreate the conditions that enabled the original private placement, a number of common practices have emerged among practitioners in connection with Section 4(a)(1½) transactions, similar to those typically applicable to Section 4(a)(2) or Regulation D private placements, including:

- the purchaser agreeing to resale restrictions and making representations and warranties regarding its sophistication and investment intent;
- inquiring into the identity of the purchaser, including its financial condition, in order to assess the likelihood that the purchaser will be able to hold the securities for investment and not resell prematurely;
- requiring legal opinions confirming the view that no registration is required for the offering;
- including restrictive legends on the securities to alert the purchaser to the restricted nature of the securities;⁴
- requiring stop transfer instructions from the issuer;⁵ and
- using a large minimum investment to bolster the purchaser’s claims regarding its sophistication and investment intent.

These common practices are typically memorialized in provisions contained in a securities purchase agreement entered into between the seller and the purchaser or, if the Section 4(a)(1½) transaction is structured in the form of a block trade, a sales agency agreement (if the financial intermediary is acting as agent). In the case of a block trade, the financial intermediary also may want to conduct due diligence on the issuer and have the issuer issue a press release regarding the completion of the offering.

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### Block Trades and the Section 4(a)(7) Exemption

**What is the Section 4(a)(7) resale exemption?**

Section 76001 of the Fixing America’s Surface Transportation Act (“FAST Act”), signed into law on December 4, 2015, incorporates the provisions of the Reforming Access for Investments in Startup Enterprises Act that codify a new Section 4(a)(7) under the Securities Act (“Section 4(a)(7)”). Section 4(a)(7) became effective immediately after the FAST Act was signed into law.

Section 4(a)(7) provides an exemption (the “Section 4(a)(7) resale exemption”) for certain accredited investor transactions involving unregistered resales and partially resembles the Section 4(a)(1½) exemption for private resales of restricted securities although it is more limited in scope (see “How does the Section 4(a)(7) resale

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⁴ If the seller is an affiliate, the legend should clearly indicate that the securities are restricted securities within the meaning of Rule 144(a)(3) under the Securities Act and cannot be resold publicly under Rule 144 until the purchaser meets the holding period requirement of Rule 144(d), which restarts upon the acquisition of the securities from an affiliate.

⁵ The seller will often arrange to have the issuer issue a stop transfer order to the transfer agent for the restricted securities to prevent the purchaser from reselling the securities purchased in the Section 4(a)(1½) offering without obtaining a legal opinion with respect to the legality of the resale.
The Section 4(a)(7) resale exemption is a non-exclusive safe harbor, so Section 4(a)(1½) remains available.

What are the requirements of the Section 4(a)(7) resale exemption?

Section 4(a)(7) exempts resale transactions that satisfy the following requirements:

- each purchaser is an accredited investor;
- neither the seller nor any person acting on the seller’s behalf engages in any form of general solicitation; and
- in the case of a non-reporting issuer that is neither (1)(a) exempt from reporting requirements pursuant to Rule 12g3-2(b) under the Exchange Act (“Rule 12g3-2(b)) nor (b) a foreign government eligible to register securities on Schedule B, then (2) at the seller’s request, the seller and a prospective purchaser must obtain from the issuer reasonably current information, including:
  - the issuer’s exact name (as well as the name of any predecessor);
  - the address of the issuer’s principal place of business;
  - the exact title and class of the offered security, including its part or stated value;
  - the current capitalization of the issuer;
  - details for the transfer agent or other person responsible for stock transfers;
  - a statement of the nature of the issuer’s business that will be presumed current if it is as of 12 months before the transaction date;
  - information about any broker, dealer or other person being paid a commission or fee in connection with the sale of the securities;
  - the issuer’s most recent balance sheet and profit and loss statement and similar financial statement, prepared in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”) or, in the case of a foreign issuer, the International Financial Reporting Standards (“IFRS”), for the two preceding fiscal years during which the issuer has been in business; and
  - if the seller is an affiliate, a statement regarding the nature of the affiliation accompanied by a certification from the seller that it has no reasonable grounds to believe that the issuer is in violation of the U.S. securities laws or regulations.

When is the Section 4(a)(7) resale exemption not available?

The Section 4(a)(7) resale exemption is not available if: (1) the seller is a direct or indirect subsidiary of the issuer; (2) the seller or any person that will be compensated in connection with the transaction is disqualified as a bad actor pursuant to Rule 506(d)(1) of Regulation D or disqualified pursuant to Section 3(a)(39) of the Exchange Act; (3) the issuer is a blank check, blind pool or shell company, special purpose acquisition company, or in bankruptcy or receivership; (4) the transaction relates to a broker-dealer’s or underwriter’s unsold
allotment; or (5) the security that is the subject of the transaction is part of a class of securities that has not been authorized and outstanding for at least 90 days prior to the transaction date.

Are securities sold in a Section 4(a)(7) resale transaction “restricted securities”?
In contrast to securities sold pursuant to Rule 144, securities sold pursuant to the Section 4(a)(7) resale exemption are “restricted securities” under the Securities Act and, therefore, subject to transfer restrictions. A transaction effected pursuant to the Section 4(a)(7) resale exemption will not be deemed to be a “distribution” under the Securities Act.

Are securities sold in a Section 4(a)(7) resale transaction subject to state “blue sky” laws?
The securities sold in a Section 4(a)(7) resale transaction are “covered securities” under Section 18(b) of the Securities Act and, therefore, exempt from state blue sky laws.

How does the Section 4(a)(7) resale exemption differ from the Section 4(a)(1½) exemption?
Under the Section 4(a)(7) resale exemption, the seller must provide any prospective purchaser with a substantial amount of information on any non-reporting issuer that is neither (1) able to rely on the exemption under Rule 12g3-2(b) nor (2) a foreign government eligible to register securities on Schedule B (see “What are the requirements of the Section 4(a)(7) resale exemption?”). Moreover, unlike the Section 4(a)(1½) exemption, resale transactions conducted pursuant to the Section 4(a)(7) resale exemption are subject to bad actor disqualifications (see “When is the Section 4(a)(7) resale exemption not available?”).

How would a Section 4(a)(7) resale transaction likely be documented?
As in a resale transaction conducted pursuant to the Section 4(a)(1½) exemption, the terms of a Section 4(a)(7) resale transaction would typically be memorialized in a securities purchase agreement between a seller and a purchaser. The securities purchase agreement would also contain representations and covenants establishing, among other things, that: (i) all purchasers are accredited investors; (ii) neither the seller nor any person acting on the seller’s behalf engages in any form of general solicitation; and (iii) neither the seller nor any person that will be compensated in connection with the transaction is disqualified as a bad actor pursuant to Regulation D or the Exchange Act (for additional information that would likely be covered by a representation and/or covenant in the securities purchase agreement, see “When is the Section 4(a)(7) exemption not available?”).

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