

Client Advisory

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Making the Most of a Difficult Market: Public Offering Structures That Maximize Flexibility and Limit Risk

Introduction

The recent turmoil in the capital markets has made capital raising extremely challenging for all kinds of issuers, with many finding that traditional public offerings are not a currently viable option. In a volatile capital market, it is critical for issuers seeking equity financing to be able to act quickly when presented with favorable market conditions, to avoid the potential downward pressure on stock prices that accompanies the announcement of a traditional offering, and to manage market and investor expectations regarding offering size and price. “Registered direct” offerings and “at-the-market” offerings are offering structures that enable public issuers and placement agents to quickly and discreetly raise capital while realizing all of the foregoing advantages. This advisory describes the characteristics of these offering types, and summarizes some of the advantages, costs, legal and business issues that issuers and placement agents may want to consider in undertaking such offerings.

Registered Direct Offerings

- A registered direct offering is a public offering of securities pursuant to an effective shelf registration statement directly to a select group of investors. Registered direct offerings are not normally subject to the SEC review process because securities are offered and sold pursuant to a registration statement on Form S-3 (i.e., a shelf registration statement), which is already effective prior to the initial marketing and announcement of the offering. The registration statement is updated by filing a prospectus supplement immediately before the offering is priced; in certain circumstances, it may be advisable to file an 8-K or otherwise disclose material information before investors make an investment decision to purchase securities in the offering if the periodic filings already incorporated by reference into the registration statement do not include sufficient information.
- A key advantage of registered direct offerings is that they can be marketed to potential institutional investors before the offering is announced, allowing issuers to test the market without the publicity (and opportunities for arbitrage) associated with traditional public offerings, which many issuers may find difficult to consummate in the current market environment.
- To address selective disclosure concerns, potential investors typically are required to enter into confidentiality agreements before being provided with full information about the offering. Registered direct offerings typically are announced and priced on the same day, and an issuer therefore can avoid downward pressure on its stock price, which frequently occurs between the time a traditional “road show” is announced and the date of pricing and closing.
- Although registered direct offerings resemble PIPE (private investment in public equity) transactions to the extent that they typically are marketed by a placement agent to a select group of accredited or institutional investors and not purchased by an underwriter on a principal basis, the shares sold pursuant to a registered direct offering are registered with the SEC, and therefore immediately transferable by purchasers in the offering. As a result, shares sold in a registered direct offering generally are priced more favorably than securities sold in a PIPE offering, which often must be sold at a greater discount to prevailing market prices. Also, in contrast to a PIPE, registered direct offerings eliminate the need to prepare and file a resale registration statement with respect to the offered securities following the closing because the offering of the shares has already been registered.

- An issuer must have a shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers) for a primary offering already effective in order to conduct registered direct offerings (though well-known seasoned issuers can file an automatic shelf registration statement, which is immediately effective, for this purpose). Once the issuer and any placement agents are ready to price the offering, the issuer and placement agents will enter into a placement agency agreement and the issuer will need to file a prospectus supplement naming the placement agent and describing the general terms of the placement agency agreement. In addition, a Current Report on Form 8-K will need to be filed, including the placement agency agreement and the form of subscription or purchase agreement as exhibits.
- The placement agency agreement between the issuer and the placement agent usually provides that the placement agent will use its best efforts to identify potential investors and solicit offers to purchase securities from the issuer.
- As with any public offering, both the issuer and the agent will need to be comfortable that the issuer's public disclosure is adequate and current, free of material misstatements and omissions.
- Placement agency agreements provide for the protections customarily seen in underwritten public offerings, including accountants' comfort letters, opinions of counsel, representations and warranties of the issuer and certificates to the agent from officers of the issuer, and a placement agent will also need to perform satisfactory due diligence. This results in a somewhat higher transaction cost than a PIPE typically would entail.
- Once a registered direct offering has been priced, a prospectus supplement has been filed with the SEC, and either a prospectus supplement or, if permissible, a free writing prospectus, is delivered to investors, the issuer and each investor in the offering will enter into a purchase or subscription agreement. In addition, each investor will wire funds to an escrow agent pending the closing of the transaction, unless the offering is conducted on an "any-or-all" basis with no minimum offering size (as opposed to a "minimum-maximum" or "all or none" basis), in which case funds may be delivered to the issuer directly. Registered direct offerings typically close through electronic issuance by an issuer's transfer agent of book-entry shares directly to investors (or their broker or nominee). This requires more logistical coordination by issuers on the day of closing than a firm commitment underwriting, where shares are issued only to a lead underwriter.
- In order to be eligible to undertake a registered direct offering, an issuer must be eligible to use Form S-3 for primary offerings (i.e., have a market capitalization of at least \$75 million (excluding shares held by affiliates) or be listed on a national securities exchange and not sell more than one-third of their public float in any 12-month period, and be current in its public filings, among other things). In addition, due to FINRA regulations and constraints imposed by Regulation M and other SEC requirements, issuers with less than \$150 million in market capitalization held by non-affiliates will be limited in their ability to engage in registered direct offerings until certain approvals are obtained or other conditions met. Well-known seasoned issuers have the most flexibility, including the flexibility to file an automatically effective registration statement.
- As is the case with traditional public offerings, registered direct offerings are subject to regulation by the SEC and applicable stock exchange rules. Regulation M and other anti-manipulation regulations apply to registered direct offerings. Stabilization is not permitted in "best efforts" offerings. The market-making and other trading activities of the agent in the issuer's securities may be restricted by law or under the applicable placement agency agreement. If an issuer intends to sell shares in excess of 20% of the total outstanding shares prior to the offering, and those shares will be sold at a discount to book or market value, exchange rules may require shareholder approval for the offering.

At-the-Market Offerings

- An at-the-market offering involves the sale of equity securities into the market at prevailing market prices under Rule 415(a)(4), rather than a fixed price in a single offering. At-the-market offerings typically are conducted over an extended period of time. At-the-market equity offerings work well in the current challenging capital markets environment because they allow public company issuers and placement agents to raise capital quickly with limited advance disclosure (minimizing arbitrage opportunities).
- Typically, a public company issuer will enter into a distribution agreement with a placement agent that provides for a maximum number of shares and/or maximum aggregate offering price to be sold over time. Neither the issuer nor the agent is obligated to sell any shares until the issuer delivers a notice to the agent that it intends to sell and the agent accepts this notice; even then, the issuer may stop an offering at any time. The notice will specify the amount of shares to be issued, any minimum selling (floor) price, and the duration of the selling period. The agent earns a commission only on what is sold.

- An issuer must have a shelf registration statement on Form S-3 (or F-3 for foreign private issuers) for a primary offering already effective in order to conduct at-the-market offerings. When an issuer enters into a distribution agreement with an agent, a prospectus supplement will need to be filed naming the agent and describing the general terms of the distribution agreement. In addition, a Current Report on Form 8-K will need to be filed, including the distribution agreement as an exhibit. Apart from this initial disclosure, there are no explicit immediate requirements for the disclosure of any individual sale of shares, although general considerations of materiality may require disclosure of transactions that, individually or in the aggregate, reach certain thresholds. An issuer will have to report at-the-market sales not less than quarterly in its periodic reports.
- Distribution agreements can provide for sales by an agent on either an agency or principal basis, but in either case the agent faces traditional underwriter liability in connection with a public offering. As with any public offering, both the issuer and the agent will need to be comfortable that the issuer's public disclosure is adequate and current, and free of material misstatements or omissions.
- Distribution agreements provide for customary underwriter protections including accountants' comfort letters, opinions of counsel, representations and warranties of the issuer and certificates to the agent from officers of the issuer, and placement agents will need to perform satisfactory due diligence. These certificates and other documents are generally updated not less than quarterly and may need to be updated more frequently, and ongoing "bring-down" due diligence will likely be required.
- Distribution agreements typically limit the amount of shares to be sold on any given day. A limit of 25% of daily trading volume is a common limitation.
- Note that this diligence and documentation will require up-front costs for the issuer (and the agent, though distribution agreements often provide that agents' fees be reimbursed under some circumstances), even if little or no capital is raised. However, it avoids the need to start due diligence and documentation from scratch, as is the case in a customary market offering.
- In order to be eligible to undertake a registered direct offering, an issuer must be eligible to use Form S-3 for primary offerings (i.e., have a market capitalization of at least \$75 million (excluding shares held by affiliates), or be listed on a national securities exchange and not sell more than one-third of its public float in any 12-month period, and be current in its public filings, among other things). In addition, due to FINRA regulations and constraints imposed by Regulation M and other SEC requirements, issuers with less than \$150 million in market capitalization held by non-affiliates will be limited in their ability to engage in at-the-market offerings until certain approvals are obtained or other conditions met. Well-known seasoned issuers have the most flexibility, including the flexibility to file an automatically effective registration statement.
- Regulation M and other anti-manipulation regulations apply to at-the-market offerings. Stabilization and passive market making are not permitted in at-the-market offerings under Regulation M. In addition, sales under an at-the market offering may need to be reported "on the tape." The market-making and other trading activities of the agent in the issuer's securities may be restricted by law or under the applicable distribution agreement.

For additional information about at-the-market or registered direct offerings, contact one of the members of Katten's Securities Practice listed below.

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