

# Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

## RAISING EQUITY CAPITAL AS A PUBLIC COMPANY: CMPO AND PIPE

Albert Lung  
Jeffrey Letalien

April 29, 2020



# CMPO: Confidentially Marketed Public Offering

- Constraints and disadvantages of traditional fully-marketed follow-on public offering:
  - Downward pressure on stock price after announcement of offering;
  - Short selling and volatility;
  - Lack of control in premarketing and building a book;
  - Inability to adapt to quickly changing market circumstances; and
  - No speedy execution
- CMPO offers a solution:
  - Confidentially test the market by conducting premarket offering without public disclosure: minimal impact on stock price
  - Flexibility in timing and no adverse effect if deal is aborted;
  - Speedy execution;
  - Lower costs to issuer.

# CMPO Process: Overview (Part I)

- CMPO is a registered public offering and must be made pursuant to a shelf registration on Form S-3:
  - Effective S-3 is necessary to ensure that the deal can be executed quickly without delay associated with SEC review, and to take advantage of market conditions.
- Organizational Meeting
  - Due Diligence by Underwriter: Business, accounting and legal
  - Preparation of documents
- Underwriter commences confidential marketing:
  - The process is designed to comply with Regulation FD and insider trading laws.
  - Phase 1: No-name contact to accredited institutional investors, hedge funds, PE, and mutual funds. If interested, potential investors will agree to receive material non-public information about the company pursuant to a confidentiality undertaking/agreement.
  - Phase 2: Wall Cross: Underwriter reveals the names of the company and the proposed offering terms and other information, primarily publicly available information.
  - Cleansing process: If the offering is abandoned, investors may require the company to make a public “cleansing” statement so that the investor is no longer restricted to trade shares.

# CMPO Process: Overview (Part II)

- Pubic marketing phase: If the underwriter is successful in building a book in the confidential marketing process, then it will “flip” the offering to the public phase by launching the transaction:
  - Compliance with NASDAQ corporate governance rules to avoid shareholder approval requirement: public offering exemption.
  - Round out retail investors and other institutional clients.
  - Public phase is brief: usually launch immediately after close of market and price before the market opens the next day, hence the reference to “overnight” offering.
- Public launch process and documentation:
  - Preliminary prospectus supplement to S-3: Deal information is omitted pursuant to 430B.
  - Rule 134 press release
  - Form 8-K or FWP
- Pricing and Closing:
  - Pricing call between pricing committee and bankers
  - Execution of underwriting agreement/delivery of comfort letter
  - Preparation and filing of final prospectus supplement
  - Closing T+2: transfer of shares and wiring of fund; delivery of legal opinion, bring-down comfort letter, etc.

# CMPO: Shelf Registration Statement on Form S-3

- Shelf Take Down: Form S-3 becomes effective and can be “taken down” anytime when market price is optimal. No need to update the S-3 (unlike S-1) because it allows incorporation by reference to Exchange Act filing.
- Calculation of shelf availability: if needed to file a 462(b) registration statement prior to pricing to upside 20%.
- Confirmation of S-3 eligibility:
  - Public float requirement: \$75 million market value of non-affiliated shares. 60-day look back period. If not eligible, check “Baby shelf rule” below.
  - Compliance with SEC periodic filings: timely filing for 12 months, e.g., 10-K, 10Q and 8-K (but only specific items).
- Baby shelf rule: SEC provides relief for small cap companies that do not meet the \$75 million public float requirement.
  - Company can sell up to 1/3 of its public float during a 12-month period.
  - Because the 60-day look back, a company can immediately access additional amount once the \$75 million public float threshold is met.
- Expiration of Shelf Registration Statement: 3 years from the effective date.

# NASDAQ and FINRA Process

- NASDAQ Additional Listing Notification
- NASDAQ corporate governance requirement:
  - Shareholder approval is required for private placement of securities below market price if the offering exceeds 20% of issued and outstanding shares.
  - Public offering exemption: No specific definition but multi-factor test
- FINRA Review Process:
  - FINRA's mandate is to review the transaction to ensure that compensation to underwriters is reasonable and fair, and to ensure there is no conflict of interest in the transaction.
  - Usually a same day review is available for shelf takedown in a CMPO
  - Disclosure issues in S-3 and preliminary prospectus if the underwriter has conflict, such as affiliate participating in the offering or the underwriter or its affiliate is a major shareholder of the issuer.

# Legal Documentation

- Preliminary prospectus supplement to S-3: Serves as the main disclosure document for the public phase of CMPO.
  - Disclosure package/incorporation by reference: make sure that material information is disclosed / 10-Q and 10-K timing
- Investor presentation and marketing materials.
- Underwriting Agreement.
- Auditors Comfort Letter and circle ups: Exchange Act filings
- Legal opinion and negative assurance letter
- Lockup Agreement: Executed by insiders, or controlling stockholders 30 to 90 days.
- Form 8-K: Item 1.01 material agreement
- Final Prospectus Supplement
- Press release

# Impact of COVID-19

- Raising capital through public offering has become more difficult as a result of the uncertainty and significant declines of stock market, and many investors are waiting for the pandemic to pass before investing in equity.
  - Shifting economy to new environment as population is sheltered at home: industries such as healthcare, particular telemedicine, eCommerce platforms supporting education and consumer spending and other have benefited.
- Specific issues affecting CMPO:
  - S-3 eligibility: Declining stock price causes companies to fall below the \$75 million public float requirement. More reliance on Baby Shelf Rules, but may not be sufficient availability.
  - SEC Periodic Reporting Requirement: Even though SEC has provided relief by extending deadline for filing of periodic report, there is no relief for Securities Act filings and “staleness” rule for financial statement continues to apply.
  - Disclosure Issues: Risk factors discussing the impact of pandemic.



# PIPE: Private Investment in Public Equity

- Unregistered Offering
  - Private placement by a public company exempt from registration
  - No need to have an effective shelf registration statement or to qualify for S-3 eligibility
  - Lack of registration statement enables preserving confidentiality until deal is signed
  - No need to prepare an offering document in advance
  - Investors need to qualify for a private placement (typical investors are accredited investors under Regulation D)

# PIPE: Role of Investment Bank

- Underwriter vs. Placement Agent
  - No underwriting syndicate
  - Issuer usually engages a bank to act as placement agent who receives a percentage fee
  - Usually only one bank involved
  - Placement agent fee usually lower than underwriting discount
  - Placement agent does not act as an “underwriter” under the Securities Act (less liability exposure)
  - No comfort letter process
  - Placement agent typically receives indemnification from the issuer in its engagement letter

# PIPE: Documentation

- Transaction Agreement
  - Principal agreement is a Subscription Agreement
  - Issuer and placement agent prepare and negotiate a form
  - Each investor and its counsel may seek to further negotiate the form
- Registration Rights Agreement
  - Investors receive privately placed shares, but with the issuer's agreement to file a resale registration statement within a short time period after closing
  - Registration rights do not typically include underwritten takedowns (PIPE investors rarely individually acquire large enough blocks to need underwritten offerings)
  - Net effect is to backload the registration process and avoid the roadshow and comfort processes of an offering

# PIPE: Disclosure

- No Offering Document
- Investors rely upon public filings and representations in the Subscription Agreement as to accuracy of disclosure
- Investors are often provided a confidential presentation similar to a roadshow deck
- Marketing process can be similar to confidential marketing of a CMPO
- Investors may have access to a data room and conduct their own diligence
- Reduced time and expense of preparing offering document somewhat offset by expense of negotiating subscription agreement with multiple investors and their counsel
- Investors agree to confidentiality similar to a CMPO, coupled with a similar cleansing obligation

# PIPE: Regulatory Issues

- SEC
  - Signing will be an 8-K event (1.01 and 3.02)
  - Filing of resale registration statement (in some instances where there is a large investor and the issuer is not eligible for Form S-3 without reliance on the baby shelf rules, the SEC staff may disallow the resale registration statement as a “disguised primary offering”)
- Blue Sky
  - Offering of listed securities qualifies for federal preemption of blue sky laws
  - Filing of Form D for a Reg D offering also provides preemption, but states can require notice filings (blue sky practitioners will look at the number and sophistication of investors in each state to determine if a state exemption is available that negates the notice filing requirement)
- FINRA
  - Generally no obligation to obtain FINRA clearance of unregistered offerings

# PIPE: Regulatory Issues (Continued)

- Exchange Rules
  - As discussed re: CMPOs, the NYSE and NASDAQ require shareholder approval for the issuance of 20% or more of the pre-transaction outstanding shares unless there is a bona fide public offering if the price is below the market price
  - Depending upon number of offering participants, a CMPO may qualify as a bona fide public offering.
  - A PIPE cannot qualify as a bona fide public offering
- Investor Concerns
  - Many investors will desire to avoid being subject to SEC filing requirements
  - Terms of warrants or other convertible securities issued in PIPES frequently contain 4.99% (Section 16) or 9.99% (Section 13) “blocker” provisions

## PIPE: Other Considerations

- Issuers may have the ability to handpick an investor group to a greater extent than a public offering (though most issuers take an active role in bookbuilding of public offerings, as well)
- Large investors may seek rights that limit company flexibility
  - Board representation
  - Rights with respect to future offerings
    - Preemptive rights
    - Onerous warrant terms such as “full ratchet” anti-dilution
- Large investors may have blocker provisions that prevent ownership of a large enough stake at any particular time to be affiliates but still exercise significant influence through contractual veto rights and the ability to continually exercise/convert and sell into the market, depressing the share price

# PIPEs and COVID-19

- Lack of SEC filings pre-transaction and negotiated nature of PIPE terms may cause PIPEs to be an attractive capital raising option during the pandemic
- Keep in mind the limited duty to update vs. the duty to correct
- Issuers should exercise caution with respect to the diligence process. While PIPE investors and CMPO participants can often force disclosure of a failed transaction through the cleansing obligation, the increased access to information for many PIPE investors puts pressure on the issuer's consideration as to whether information is MNPI
  - Information as to company performance during COVID-19 may not be ripe for disclosure, but a cleansing obligation could force premature disclosure
  - Issuers may be forced to disclose sensitive information about workouts with lenders, counterparties or landlords or about employee pay reductions or furloughs that would not be disclosed in the absence of a cleansing obligation



**Morgan Lewis**

**QUESTIONS?**

# Questions?



**Albert Lung**  
Silicon Valley  
[albert.lung@morganlewis.com](mailto:albert.lung@morganlewis.com)



**Jeffrey A. Letalien**  
New York  
[jeffrey.letalien@morganlewis.com](mailto:jeffrey.letalien@morganlewis.com)

# Biography



## Albert Lung

Partner

[albert.lung@morganlewis.com](mailto:albert.lung@morganlewis.com)

Silicon Valley, CA

T +1.650.843.7263

F +1.650.843.4001

Albert Lung advises companies throughout the United States and abroad on capital market transactions, corporate governance, and securities laws. His clients include publicly listed companies and investment banking firms in emerging technology, biotechnology, software, and life sciences fields. Albert advises clients in public and private offerings, compliance with US Securities and Exchange Commission (SEC) regulations and disclosure requirements, NASDAQ/NYSE listing requirements, corporate governance, investors communications, and a variety of other general corporate matters.

# Biography



Jeffrey A. Letalien represents domestic and foreign issuers, underwriters, and investors in diverse transactions. These transactions include public and private offerings and business combinations, as well as with respect to corporate governance, reporting and disclosure obligations, and other matters relating to securities regulation. Jeff regularly counsels public companies on compliance with periodic reporting requirements, complex indenture covenant requirements, and the corporate governance requirements of various stock exchanges.

## **Matthew Lewis**

Of Counsel

[Jeffrey.Letalien@morganlewis.com](mailto:Jeffrey.Letalien@morganlewis.com)

New York, NY

T +1.212.309.6763

F +1.212.309.6001

**Morgan Lewis**

## Our Global Reach

Africa  
Asia Pacific  
Europe  
Latin America  
Middle East  
North America

## Our Locations

Almaty	Chicago	Houston	Orange County	Shanghai*
Astana	Dallas	London	Paris	Silicon Valley
Beijing*	Dubai	Los Angeles	Philadelphia	Singapore
Boston	Frankfurt	Miami	Pittsburgh	Tokyo
Brussels	Hartford	Moscow	Princeton	Washington, DC
Century City	Hong Kong*	New York	San Francisco	Wilmington



# Morgan Lewis

\*Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

# THANK YOU

© 2020 Morgan, Lewis & Bockius LLP  
© 2020 Morgan Lewis Stamford LLC  
© 2020 Morgan, Lewis & Bockius UK LLP

Morgan, Lewis & Bockius UK LLP is a limited liability partnership registered in England and Wales under number OC378797 and is a law firm authorised and regulated by the Solicitors Regulation Authority. The SRA authorisation number is 615176.

Our Beijing and Shanghai offices operate as representative offices of Morgan, Lewis & Bockius LLP. In Hong Kong, Morgan Lewis operates through Morgan, Lewis & Bockius, which is a separate Hong Kong general partnership registered with The Law Society of Hong Kong as a registered foreign law firm operating in Association with Luk & Partners. Morgan Lewis Stamford LLC is a Singapore law corporation affiliated with Morgan, Lewis & Bockius LLP.

This material is provided for your convenience and does not constitute legal advice or create an attorney-client relationship. Prior results do not guarantee similar outcomes. Attorney Advertising.