Morgan Lewis

GLOBAL PUBLIC COMPANY ACADEMY

RAISING EQUITY CAPITAL AS A PUBLIC COMPANY: FROM PIPE TO CMPO

March 24, 2021

Albert Lung and Jeff Letalien

Presenters

Albert Lung
Partner, Silicon Valley/
San Francisco

Jeffrey Letalien
Of Counsel, New York

Morgan Lewis

CMPO

Morgan Lewis

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.
  - S-1 CMPO is possible, but pricing risk is enhanced due to the 2-day acceleration request with the SEC.
- 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.
    - Cleaning process: If the offering is abandoned, investors may require the company to make a public "cleanse" statement so that the investor is no longer restricted to trade shares.

CMPO Process: Overview (Part II)

- Public 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 upsize 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/NYSE and FINRA Process

- NASDAQ Additional Listing Notification/NYSE Supplemental Listing Application
- NASDAQ/NYSE 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
  - Exemption for filing: public float test: $150 million
  - 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

- COVID-19 has not significantly reduced the demand for CMPO
- Management presentation and meeting are all done online even prior to pandemic
- Logistical issues: signing of documents, delivery of good standing certificates, etc.
- Disclosure issues: Risk factors discussing the impact of pandemic—SEC guidance/due diligence

PIPE

Morgan Lewis

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

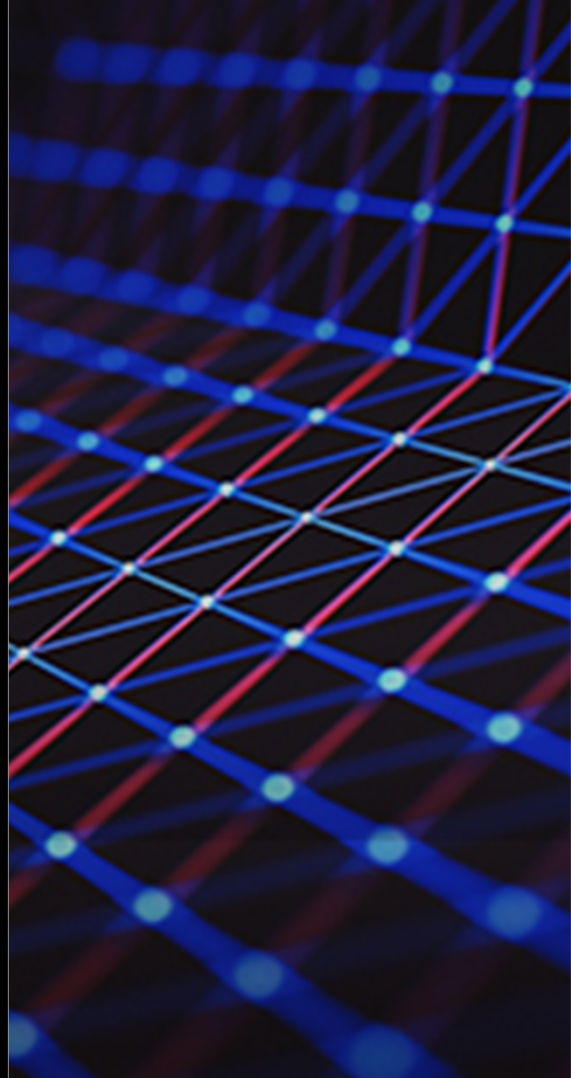
- Lack of SEC filings pre-transaction and negotiated nature of PIPE terms cause PIPEs to continue to be an attractive capital raising option during the pandemic
- Keep in mind the limited duty to update vs. the duty to correct
- Issuers should exercise caution with respect to the diligence process. While 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

Coronavirus COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at **www.morganlewis.com/topics/coronavirus-covid-19**

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to **subscribe** using the purple "Stay Up to Date" button.



Morgan Lewis

Biography

Albert Lung
Silicon Valley/San Francisco
albert.lung@morganlewis.com

Albert advises companies throughout the United States and abroad on capital market transactions, corporate governance, and securities laws. His clients include publicly listed companies, investment banking firms and institutional stakeholders in emerging technology, semiconductor, biotechnology, software, life sciences and utility industries. Albert advises clients in public and private offerings of equity and debt securities, compliance with US Securities and Exchange Commission (SEC) regulations and disclosure requirements and periodic reporting obligations under the Securities Exchange Act of 1934, NASDAQ/NYSE listing requirements, corporate governance, investors communications, and a variety of other general corporate matters.

Biography

Jeffrey A. Letalien
New York
jeffrey.letalien@morganlewis.com

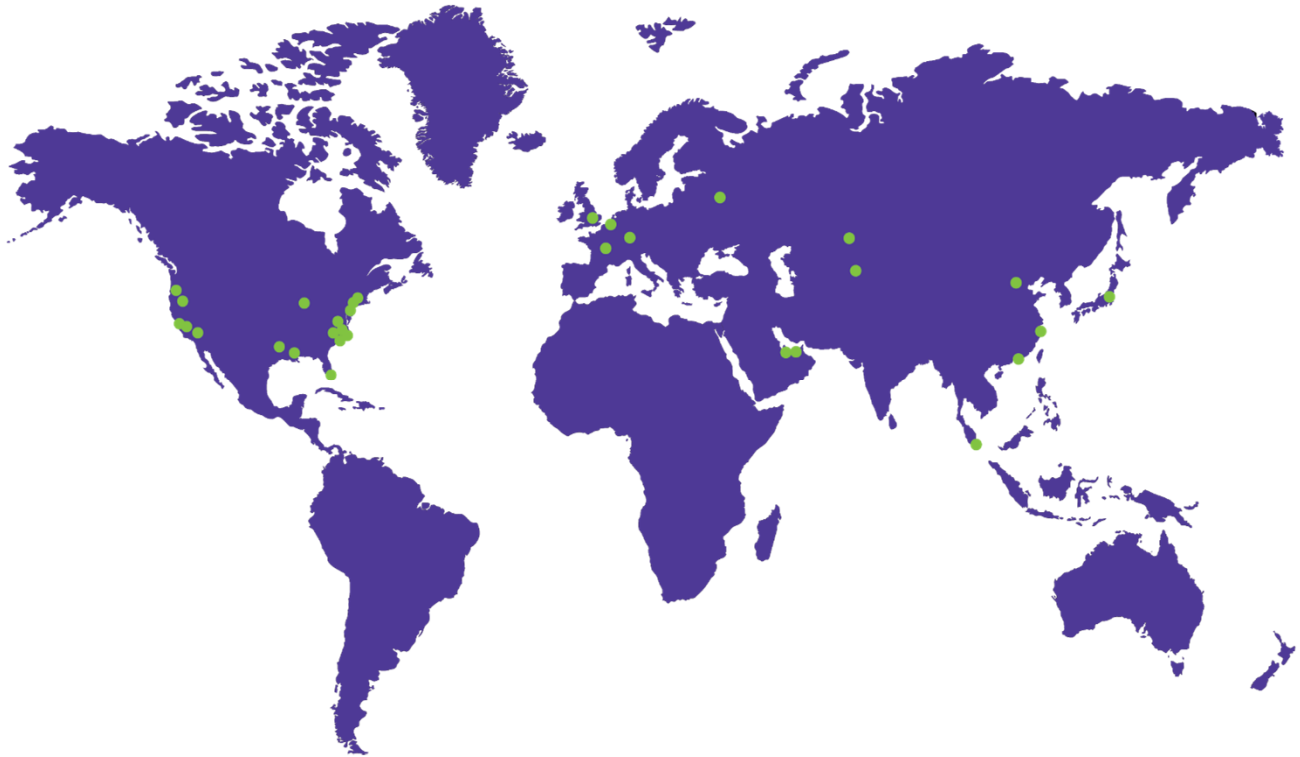
Jeff represents domestic and foreign issuers, underwriters, and investors in diverse transactions, including public and private offerings. He regularly represents buyers and sellers, including special purpose acquisition companies (SPACs), in connection with disclosure, filing and other securities law aspects of large and complex business combinations. Jeff regularly counsels public companies with respect to corporate governance, reporting and disclosure obligations and compliance with complex indenture covenant requirements. He is a member of the firm's SPAC Task Force.

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

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



Morgan Lewis

THANK YOU

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.