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Raising Capital in the Current Environment V: ATM Programs and Rights Offerings

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Today's Panelists

Hillary H. Holmes is a partner in the Houston office of Gibson, Dunn & Crutcher, Co-Chair of the firm's Capital Markets practice group, and a member of the firm's SRCG, Oil and Gas, M&A and Private Equity practice groups. Ms. Holmes advises companies in all sectors of the energy industry on long-term and strategic capital planning, disclosure and reporting obligations under U.S. federal securities laws, ESG matters and corporate governance issues. She has deep experience with all types of equity and debt capital markets transactions, including ATM programs. Ms. Holmes is *Chambers* Band 1 ranked for Capital Markets Central U.S. and ranked for Energy Transactional Nationwide. Ms. Holmes also advises boards of directors, special committees and financial advisors in transactions and situations involving complex issues and conflicts of interest.

Brian Lane, a partner with Gibson, Dunn & Crutcher, is a corporate securities lawyer with extensive expertise in a wide range of SEC issues. He counsels companies on the most sophisticated corporate governance and regulatory issues under the federal securities laws. He is a nationally recognized expert in his field as an author, media commentator, and conference speaker. Mr. Lane ended a 16 year career with the Securities and Exchange Commission as the Director of the Division of Corporation Finance, where he supervised over 300 attorneys and accountants in all matters related to disclosure and accounting by public companies (e.g. M&A, capital raising, disclosure in periodic reports and proxy statements). In his practice, Mr. Lane advises a number of companies undergoing investigations relating to accounting and disclosure issues.

Ryan Murr is a partner in the San Francisco office of Gibson, Dunn & Crutcher, where he serves as a member of the firm's Corporate Transactions Department, with a practice focused on representing leading companies and investors in the life sciences and technology space. Mr. Murr currently serves as a Co-Chair of the firm's Life Sciences Practice Group and previously served as a member of the firm's Executive Committee and Management Committee. Mr. Murr represents public and private companies and investors in the biotechnology, pharmaceutical, technology, medical device and diagnostics industries in connection with securities offerings and business combination transactions. In addition, Mr. Murr regularly serves as principal outside counsel for publicly traded companies and private venture-backed companies, advising management teams and boards of directors on corporate law matters, SEC reporting, corporate governance, licensing transactions, and mergers & acquisitions.

Robyn E. Zolman is a partner in the Denver office of Gibson, Dunn & Crutcher and a member of the firm's Capital Markets, Securities Regulation & Corporate Governance and Energy Practice Groups. Her practice is concentrated in securities regulation and capital markets transactions. Ms. Zolman represents clients in connection with public and private offerings of equity and debt securities, tender offers, exchange offers, consent solicitations and corporate restructurings. She also advises clients regarding securities regulation and disclosure issues and corporate governance matters, including Securities and Exchange Commission reporting requirements, stock exchange listing standards, director independence, board practices and operations, and insider trading compliance. She provides disclosure counsel to clients in a number of industries, including energy, telecommunications, homebuilding, consumer products, life sciences and biotechnology.

Branden Berns is an associate in the San Francisco office of Gibson, Dunn & Crutcher, where he practices in the firm's Corporate Transactions Practice Group. Mr. Berns advises clients in connection with a variety of financing transactions, including initial public and secondary equity offerings and investment grade, high yield and convertible debt offerings, as well as companies, private equity firms, boards of directors and special committees in connection with a wide variety of complex corporate transactions, including mergers and acquisitions, asset sales, spin-offs, joint ventures, private placements and leveraged buyouts. Mr. Berns also advises clients regarding securities regulation, reporting requirements and corporate governance matters.

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ATM Offerings

ATM Offerings - Overview

What is an at-the-market offering?

- An offering of securities into an existing trading market at the public trading price
  - Commonly referred to as "equity distribution," "continuous offering" or "equity dribble out" programs
- Shares are "dribbled out" to the market over a period of time at prices based on the market price of the securities
  - Amounts, floor prices and duration of sales are determined by the issuer and may vary over the life of the program
  - No obligation to sell
  - Sales can be primary or secondary
- Generally, sales do not involve special selling efforts
  - Shares are sold on an agency basis through one or more sales agents
  - Ordinary broker's transactions; no solicitation
- A limited number of shares may be sold by the agent on a principal basis (i.e., purchase for its own account with a view to resale)

ATM Offerings – Advantages

Advantages of ATM Programs:

- Flexibility
- No commitment to sell; sales executed when and if the issuer wants to raise capital
- Minimal market impact; raise equity by selling stock into the natural trading flow of market
- Typically no real time disclosure of sales
- Appealing for issuers with a frequent need to raise modest amounts of capital over a long period
- Ability to better time issuances and match offering proceeds to specific uses
- Can be used at times the market may not be receptive to other types of offerings
- Take advantage of high volatility
- Lower commission than traditional follow on offerings
- Minimal management involvement; no roadshows

ATM Offerings –Drawbacks

Drawbacks of ATM Programs:

- No special selling efforts; sales executed at then current prices
- Generally smaller in size than a follow-on offering
- Market impact is greater for companies with lower trading volume
- Price depends on market pricing at the time so is subject to market fluctuations
- Program is publicly disclosed and may create an overhang
- Issuer and agent have Section 11 liability
- Refresh activities are required to have program available over time, which involves cost/effort
- Must monitor legal compliance issues during use of program over time
    - Disclosure at time of sales; trading windows; Reg M; research coverage

ATM Offerings – Market Trends

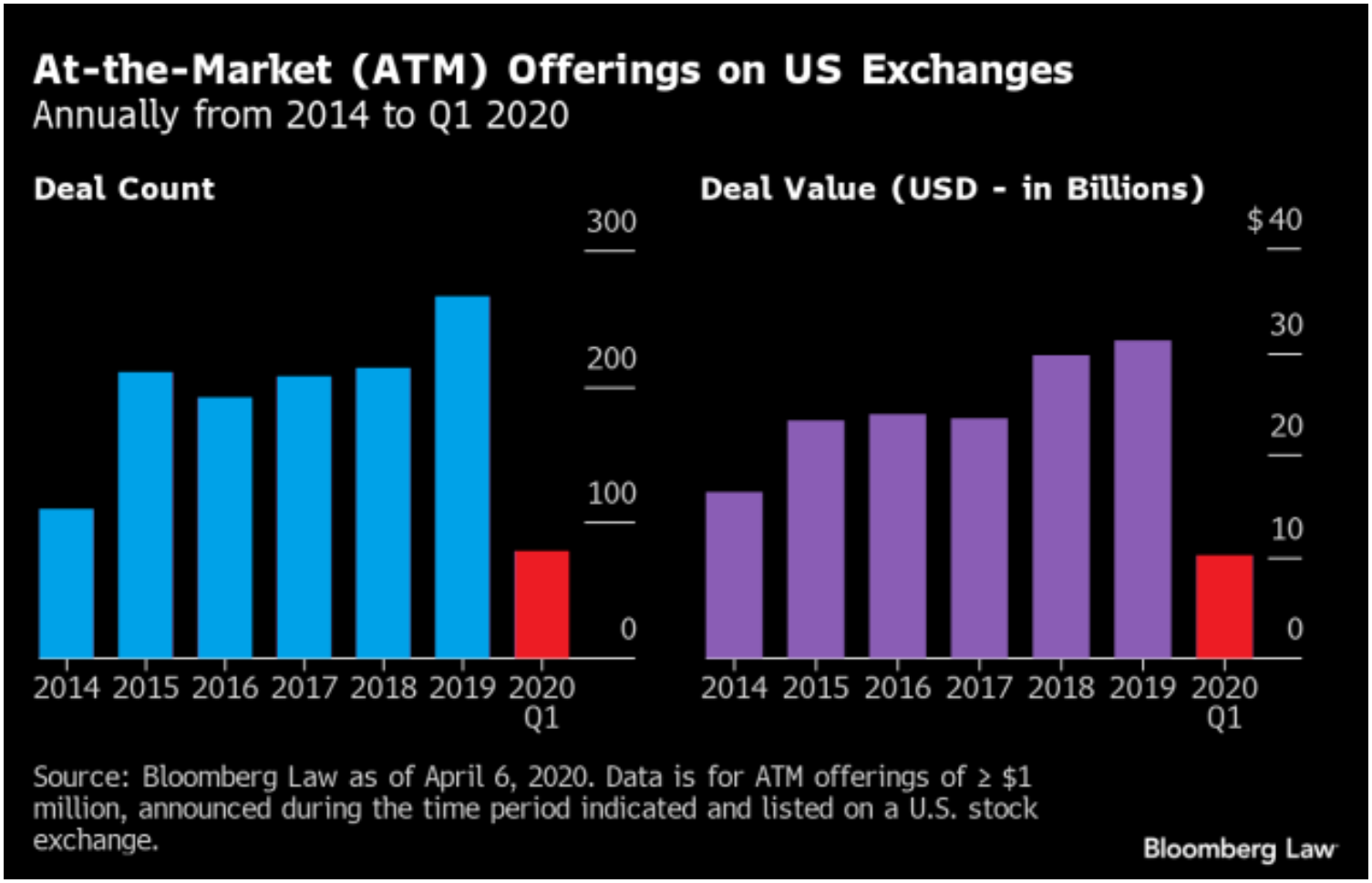
US ATM Market Trends:

- Steady increase in ATM filings from 2010-2019
- 350 filings for over $55 billion in 2019
- Uptick in Q1 2020 programs (79 programs raising $10.1 billion)

Primary Industries:

- REITs
- Healthcare
- Power
- Industrial
- Tech
- Energy

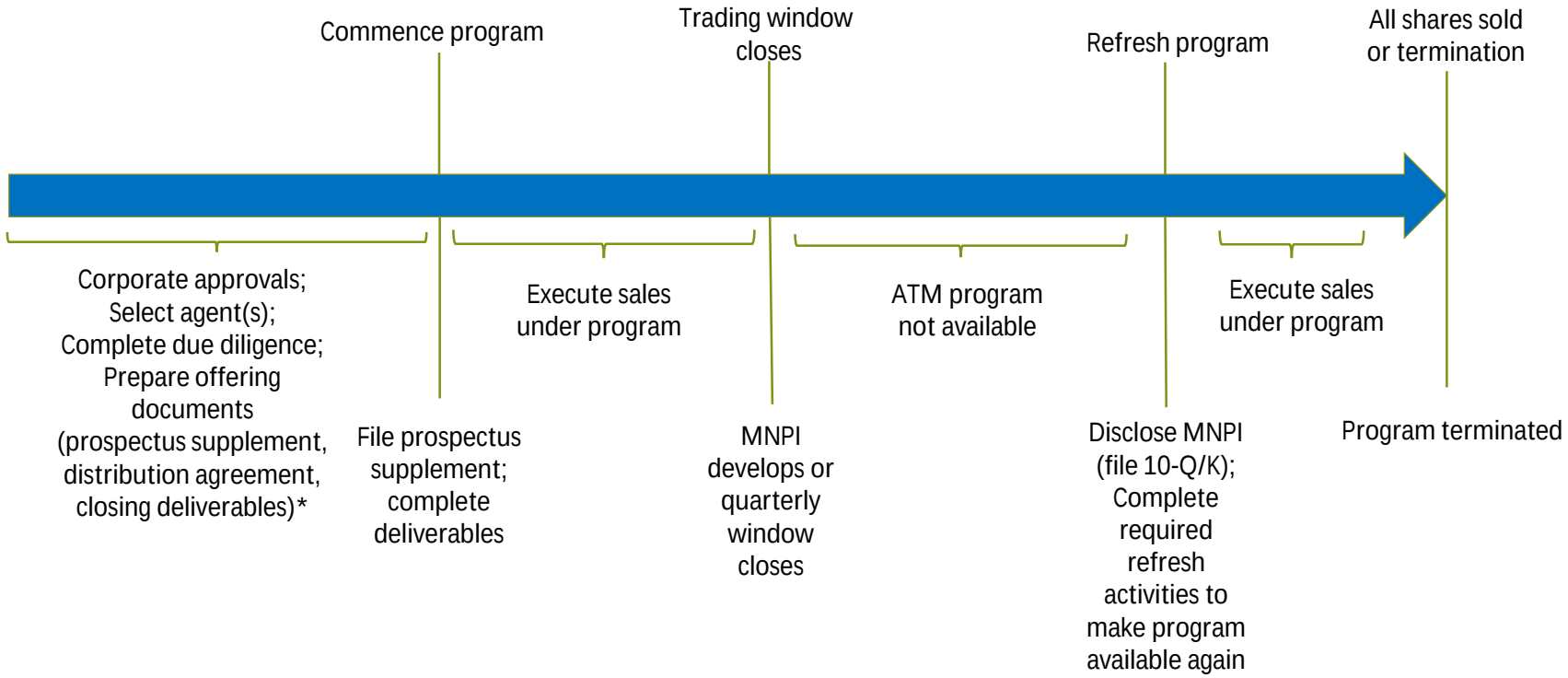
ATM Offerings – Market Trends (cont.)



ATM Offerings – Process Overview

1. Customary board approval and reservation of sufficient authorized shares
2. Issuer must be S-3 eligible and file registration statement and prospectus
3. Engage placement agent and enter into equity distribution agreement
4. Complete diligence, comfort and legal opinion exercises
5. Stock exchange listing process
6. Publicly announce the ATM program
7. Report sales on a quarterly basis or, in some cases, in real time
8. Conducts quarterly refresh activities to keep program available for sales during the quarter
9. Monitor legal and process issues throughout program; use takedown compliance checklist

ATM Offerings
Illustrative Timeline



* Assumes the issuer is already Form S-3 eligible and has an effective universal shelf registration statement that contemplates at the market sales. If the plan of distribution does not contemplate at the market sales and issuer is not a WKSI, allow an additional 14-30 days to file and have declared effective a post-effective amendment. If the issuer needs to file a Form S-3, then allow an additional 14 days for a WKSI and an additional 45-60 days for a non-WKSI to prepare and file a Form S-3.

ATM Offerings – Registration

Registration Statement

- Issuer must be eligible to use Form S-3 for primary offerings
- Can use an existing S-3 if the plan of distribution section includes necessary language
- WKSIs can register the program on an automatically effective S-3
  - But publicly traded limited partnerships are "ineligible issuers" under SEC rules; must file a non-WKSI S-3 for their ATM programs

Prospectus Supplement

- Sets out the specific terms of the ATM program
  - Size of program, description of common stock, general terms of equity distribution agreement, use of proceeds
- Identify placement agent
- Disclose compensation to agent (or at least maximum) as percentage of price per share
- If secondary program, name selling shareholders (who might be deemed underwriters)
- If a block trade or principal sales are made under the program, an additional prospectus supplement may be required
- ATM program prospectus could also be included directly in the Form S-3

ATM Offerings – Registration (cont.)

Prospectus Delivery Requirements

- Generally, a broker or dealer need not deliver a prospectus
- A broker or dealer effecting a transaction on a national securities exchange or through any trading facility is deemed under Rule 153 to have satisfied its prospectus delivery obligations if:
  - Securities of the same class are traded on a national securities exchange;
  - None of the issuer, underwriter or dealer, or the registration statement is the subject of a pending proceeding under Section 8A; and
  - The issuer has filed a 10(a) prospectus
- No requirement to deliver notice under Rule 173 for transactions solely between brokers or dealers in reliance on Rule 153

ATM Offerings – Equity Distribution Agreement

- Agreement governing the program between issuer and distribution agent(s) (broker/dealers)
- Key provisions:
  - Contemplates sales on an at-the-market (agency) basis
  - Agent compensation and expense allocation (often 1-3% sales commission)
  - Representations and warranties
  - Requirements for legal opinions and comfort letter
  - Standard indemnification and termination provisions
  - Disclosure requirements
- Similar to an underwriting agreement due to Section 11 liability
  - Indemnification and deliverables are the same as with an underwritten offering
  - Track underwriting agreement of seasoned issuer
- Side letters frequently used for specific compensation and expense reimbursement
- Provides for termination after 12-36 months or with advance notice
- May also contemplate sales on an underwritten (principal) basis

ATM Offerings - Disclosure

Disclosure upon Execution

- Prospectus Supplement (maximum gross proceeds)
- 8-K with Equity Distribution Agreement
- Exhibit 5 opinion required if using a universal shelf
- Press release is not common

Ongoing Disclosure

- Issuer must disclose the number of shares sold and proceeds raised under the program over time
  - Generally issuers include this disclosure in their 10-Qs and 10-Ks
  - Some issuers choose to disclose sales in prospectus supplements at quarter end
- Real-time disclosures may be required for material sales or sales to insiders
- Sales on a principal basis require a prospectus supplement

ATM Offerings – Selected SEC Comments

- We note your disclosure on the cover page and Plan of Distribution section of your sales agreement prospectus indicating that sales may be made to or through a market maker other than on an exchange or otherwise and in negotiated transactions. ***Please tell us whether these sales methods satisfy the "at the market" definition under Rule 415.*** If any sales method does not constitute a sales method that is deemed an "at the market" offering as defined in Rule 415 or if any material information with respect to a particular offering has been omitted, please confirm that you will file a prospectus supplement at the time of such sales or tell us why such additional filing would not be necessary.

- Given the relative size of the offering to your outstanding shares held by non-affiliates, the relationship of certain of the selling shareholders to you, the circumstances under which the selling shareholders received the shares, and the amount of time that the selling shareholders have held the shares, ***it appears that the resale of securities is by or on behalf of the issuer.*** Under Rule 415, equity securities offered by or on behalf of the issuer cannot be sold in an "at the market offering" unless the offering meets the requirements of Rule 415(a)(1)(x). As it appears that you do not meet the transaction requirements for registration of a primary offering on Form S-3, you would have to include a price for the shares and disclose that the selling shareholders are underwriters that will conduct their offering at a fixed price for the duration of the offering. Please refer to Securities Act Rule C&DI 612.09 for guidance. Please revise or provide your analysis as to why you do not believe this is an at the market offering.

ATM Offerings – Ongoing Program Maintenance

Representation Dates

- Program set up
- Each 10-Q or 10-K filing date during life of the program
- Certain other key filings or upon the agents' request
- Negotiate waiver provisions in event program is not to be used

Deliverables on each Representation Date

- Legal opinions
- Comfort letters
- Standard officers' certificates bringing down all representations and warranties and confirming compliance with covenants
- Legal diligence and diligence calls with management and auditors/experts

Stock Exchange Requirements

- Listing application for maximum amount under program at set up; notifications upon issuance

ATM Offerings – Regulation M Considerations

- Be mindful of existing repurchase programs/transactions:
  - Announced stock buyback program or indirect buyback efforts
  - DRIPs
  - Insider purchases
- Plan timing of sales under ATM program carefully to avoid Reg M or market manipulation issues
  - Consider suspending stock repurchase or DRIP programs
- If an issuer intends to set up multiple ATM programs, each using different selling/distribution agents, it should take care to ensure that different agents are not selling during the same periods

ATM Offerings – Trading Blackouts and Agent Issues

- ATM program not available during a trading blackout
  - When sales are made, issuer is deemed to confirm representation that the issuer possesses no MNPI
  - Use of ATM program should follow standards in issuer's insider trading policy (including quarterly blackout, subject to unique circumstances)
  - 10b5-1 trading plan for issuers does not solve Section 11 issues
- Issuer should be on agent's watch / restricted list
  - Comply with issuer's trading blackouts
  - Monitor research coverage and use of Rule 169 exemption
  - Manage conflicts of interest if the agent's firm will serve as a financial advisor

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Rights Offerings

Rights Offerings - Overview

What Is a Rights Offering?

A rights offering involves a Company issuing (via dividend) to its existing stockholders for each of its outstanding shares a subscription "right" (or fraction of a subscription "right") to purchase, as of a predetermined record date, a share of the Company at a specific price per share (the "subscription price"), which is typically set with reference to the recent trading price of the shares.

What SEC Filings Are Required?

The shares of common stock (or other equity securities) to be issued upon exercise of the subscription rights must be registered on Form S-1 (or, if the Company meets the eligibility criteria, on Form S-3). Because the subscription rights are being issued to stockholders for no consideration, registration of the subscription rights themselves is not generally required.

Standby vs. Direct Rights Offering

In a "standby" rights offering, a third party agrees in advance to purchase shares that are not subscribed for in the rights offering. In a "direct" rights offering, there is no standby purchaser and the issuer only sells shares that are subscribed for.

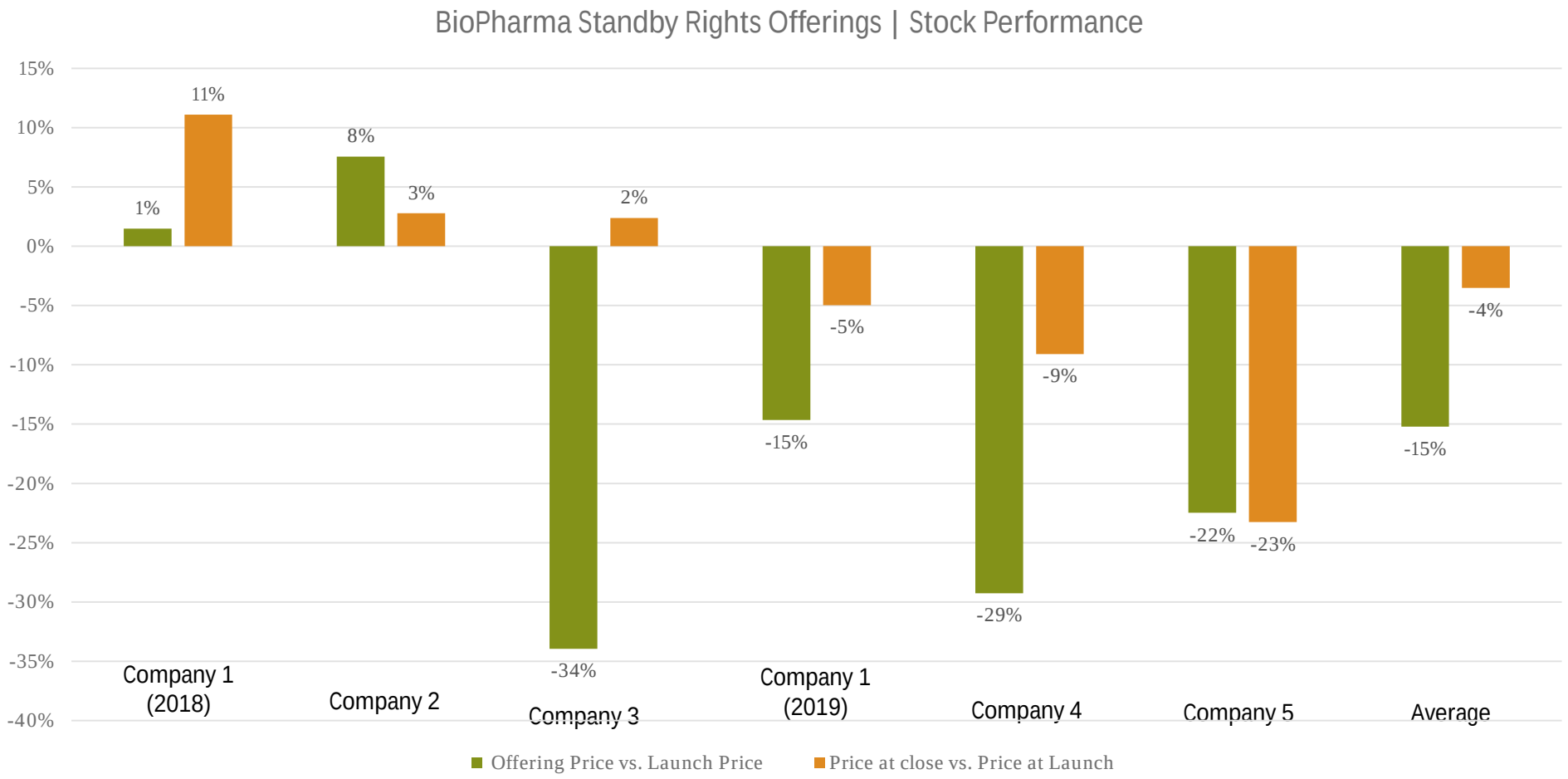
Rights Offerings - Advantages

- Rights offerings do not require stockholder approval under Nasdaq / NYSE rules, which allows for the issuance of >20% of the outstanding stock at a discount and without an underwritten offering.
- In a rights offering, all stockholders are given the right to purchase shares, so there is no dilutive effect to those who exercise the subscription rights issued to them.
    - Boards may also view this as inherently fairer than a club deal that would otherwise be highly dilutive.
- Less marketing is required (as compared to a fully marketed follow-on offering via roadshow), because the offering is made to existing stockholders.
- Where there is a financing overhang (or a large short interest that would cover through an expected offering), the rights offering mechanism may force short sellers to buy shares in advance of the record date to be able to cover their position in the offering).
- A rights offering can be fully backstopped so that it is launched with financing commitments in place at the time the offer is made public.

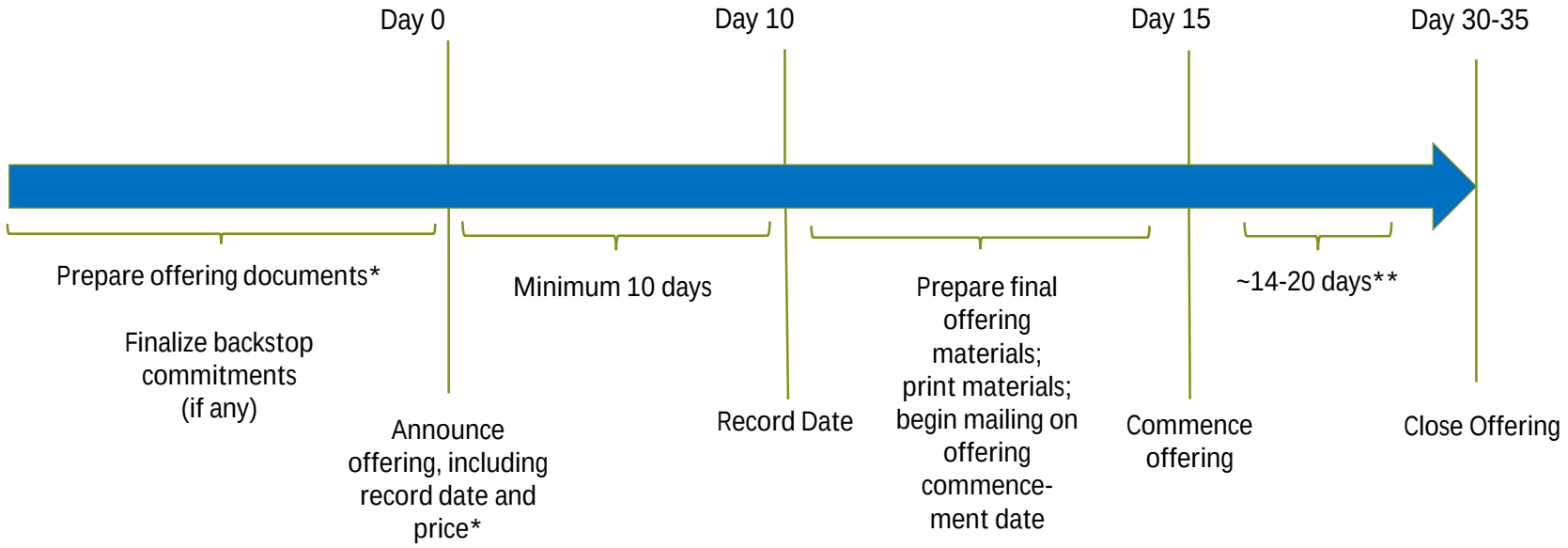
Rights Offerings - Disadvantages

- If an underwriter is used as the backstop, the commitment fees may be greater than the typical fees paid to underwriters in a registered follow-on offering.
- The sale of shares in a rights offering can result in more concentrated investor positions and decreased liquidity, depending on how the offering is ultimately distributed.
- Rights offerings are not widely used and thus not well understood among many investors, which may complicate efforts to bring in institutional investors as part of the backstop group.
- If syndicating a backstop investment group, there is inherent uncertainty as to how much of the offering the backstop investors will ultimately be required to purchase, which may make the offering less attractive.
- Rights offering requires more time to complete than traditional alternatives (PIPE, confidentially marketed public offering or fully marketed follow-on offering)

Rights Offerings - Advantages, Disadvantages (cont.)



Rights Offering - Illustrative Timeline



* Assumes the issuer is already Form S-3 eligible and has an effective registration statement with respect to the shares to be purchased upon exercise of the subscription rights. If the issuer is not Form S-3 eligible, an additional 60-75 days will be required prior to announcing the offering in order to file a Form S-1 and clear comments with the SEC.

** Typically, a rights offering will be open for a period of a couple of weeks. There are no federal securities laws requiring the rights offering to be open for a specified period of time, but there are certain timing requirements imposed by the listing exchanges.

Right Offerings - Standby Rights Offering

In a standby rights offering, a third party (usually an investment bank, a syndicate of investment banks or an affiliate of the issuer) agrees, prior to commencing the rights offering, to purchase any shares underlying rights that are not exercised in the rights offering. This is called the "backstop (or standby) commitment."

- **Advantages**
  - Issuer guarantees it can issue a sufficient amount of capital at the agreed standby commitment price
- **Disadvantages**
  - May be expensive (as compensation for bearing the risk of an under-subscription, the back-stop party is typically paid a flat standby fee, plus a per share amount for each unsubscribed share purchased by it after the subscription offer expires)
  - Backstop by an insider may trigger shareholder approval requirements under NYSE rules
- **Which issuers should consider obtaining a backstop commitment?**
  - An issuer that must raise a specific amount of capital
  - If the issuer's stock price is volatile (so that the rights won't be exercised)

Right Offerings - Direct Rights Offering

A direct rights offering does not contemplate a backstop commitment party, or a standby purchaser. Rather, the issuer sells only the number of shares that are evidenced by the exercised subscription rights.

- **Advantages**
  - Cheaper than a standby rights offering because there are no fees associated with providing the backstop commitment
- **Disadvantages**
  - A poorly subscribed direct rights offering may leave an issuer under-capitalized
- **Who should pursue?**
  - Large, well-capitalized issuers looking to raise capital but without a specific capital raising goal
  - Established issuer that can expect many shareholders to exercise their rights
  - Issuers with previously identified interest from an existing shareholder(s)

Right Offerings - Cast of Characters

The issuer will most likely require assistance from third parties. In addition to the standby purchaser, the issuer may also engage a dealer-manager, a subscription agent, and/or an information agent.

- **Dealer-manager**
  - Typically hired to market the rights offering and solicit the exercise of rights and participation in the over-subscription privilege, if any. In a non-transferable rights offering, issuers may opt to avoid marketing expenses and sales commissions by undertaking these tasks themselves.
- **Subscription Agent**
  - Typically hired to send the offering materials to the stockholders and to collect all of the completed subscription certificates and related payments from the stockholders. This role may be filled by an issuer's transfer agent.
- **Information Agent**
  - Typically hired to answer any stockholder questions and provide further information about the rights offering. If the issuer has an adequately staffed investor relations department, it may undertake this task itself.

Right Offerings - Transferability of Rights

While most rights offerings involve non-transferable subscription rights, an issuer may elect to make the subscription rights transferable by recipient stockholders to third parties.

- **Rationale**
  - In transferable rights offerings, stockholders who choose not to exercise their transferable subscription rights may trade them in the secondary market during the offering period. If the subscription price is below the current market price, the subscription rights will have value to a third party. Stockholders not participating in the rights offering are able to offset their dilution by earning a profit trading the subscription rights to third parties.
- **Mechanics**
  - Trading of the transferable rights takes place on the exchange where the issuer's common stock is listed, or over the counter if the issuer's stock is not listed on an exchange.

Right Offerings – Registration of Underlying Common Stock

In order to make the common stock that is issuable upon exercise of the subscription rights freely tradeable, an issuer must register the common stock

- An issuer that is a WKSI may register the common stock on a Form S-3ASR
- An issuer that is S-3 eligible (but not a WKSI) may register the common stock on a Form S-3
  - Issuers with a public float less than $75mm will be limited to an offering of less than 1/3 of the issuer's public float (the so-called "baby shelf" rule)
  - This offering size limitation may cause a rights offering to be impractical if the issuer's public float is depressed due to market conditions and significant capital must be raised

Right Offerings - Special Subscription Privileges

Step-up Privilege

- A "step-up privilege" may be offered to stockholders when the rights are not easily divisible by the subscription ratio. In such situation, if a stockholder fully exercises the rights, the stockholder will be permitted to subscribe for one additional full share in lieu of the fractional share that would have been granted, without furnishing any additional rights.

Over-subscription Privilege

- An "over-subscription privilege" provides a stockholder fully exercising its subscription rights, including any "step-up privilege," if applicable, to subscribe for an additional number of shares.
- This amount is typically not more than the aggregate number of shares subscribed for pursuant to the basic rights and the "step-up privilege"
- The "over-subscription privilege" is subject to allotment, and shares will be distributed on a pro rata basis if allotment does not exist to fulfill all requests.

Rights Offerings - Sufficient Authorized but Unissued Shares?

The Company must determine if its certificate of incorporation provides for sufficient authorized but unissued shares to accommodate the number of shares that could be issued in connection with the rights offering. If not, necessary corporate actions must be taken to authorize new shares. This would typically entail the lengthy and expensive process of soliciting a stockholder vote via a proxy statement.

Potential Solution

- The Company may offer a combination of common stock (to the extent of its unissued shares) and "toothless" preferred stock that is convertible into common stock following an affirmative vote by the issuer's shareholders to increase the authorized shares of common stock.
- "Toothless" preferred stock is typically economically equivalent to common stock
- The preferred stock generally has no real preference; likely non-voting (at least over a given threshold, such as 19.9%)

Rights Offerings - Avoiding an Inadvertent Change of Control

If the rights offering has relatively little participation and the backstop purchaser is purchasing a large number of shares pursuant to the backstop commitment, the backstop purchaser's percentage ownership could exceed 20% and inadvertently trigger a change of control.

Potential Solution

- The Company may wish to place a cap on the number of shares that the backstop commitment party may acquire in order to avoid an inadvertent change of control under the listing exchange rules.
- The Company and the backstop purchaser may also agree that any shares acquired in excess of 20% will not be common stock but will instead be "blocker" preferred stock that is convertible into common stock only upon 61 days notice by the holder to the Company. The "blocker" preferred stock is therefore not counted for purposes of exceeding the listing exchange 20% threshold.

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We are available for your questions.
Thank you.