

FREQUENTLY ASKED QUESTIONS ABOUT REGISTERED DIRECT OFFERINGS

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.

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.

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