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# Alternative Equity Offerings for Volatile Markets

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Recent market conditions and volatility due to the COVID-19 pandemic have produced an environment in which traditional securities offerings may prove challenging for public companies. At the same time, the global economic fallout resulting from the pandemic and the efforts to contain it may make raising equity capital all the more imperative or strategically important for certain public companies. This alert outlines four alternative equity offering types that public companies may consider in addressing their capital raising and liquidity needs.

### At-the-market offering programs

At-the-market (ATM) offering programs are public offerings of equity securities into an existing market on a continuous (or dribble-out) basis from an effective shelf registration statement. Sales are conducted by one or more broker-dealers acting as agent for the issuer and are typically made in relatively small amounts or blocks from time-to-time over the life of the program. Because the equity securities are sold over time and in smaller amounts, there may be less impact on stock price compared to a traditional follow-on offering. Following the announcement of entry into a sales agreement with one or more agents, public disclosure of sales generally are made only in the company's subsequent periodic filings, allowing sales to be made discretely over time. Agent commissions for an ATM program are almost always lower than underwriting discounts in a traditional public offering in part because no special selling efforts by the agent are made in connection with the sales; the agent is never at risk as a principal; and the agent`s exposure to liability can be more limited. Additionally, ATM programs do not involve investor presentations or roadshows and thus may be less time-consuming for management than a traditional follow-on offering.

ATM programs can be effective capital raising tools in volatile markets because they allow issuers to enter the market and sell equity relatively quickly at times and prices of their choosing, based on market demand and as and when the business requires incremental equity capital. In addition, to the extent the market might not be able to absorb significant amounts of equity capital at a single time, an issuer may find that selling equity securities during windows of relative market calm is useful. Because all parties to the ATM program are generally bringing down diligence on a quarterly basis, should an issuer have the opportunity to conduct a traditional follow-on offering or block sale, all parties to the program (participating investment banks, law firms and auditors) should be able to move quickly to efficiently execute the transaction.

One significant limitation of an ATM program is that it is not designed for an issuer to raise large amounts of capital in a short period of time (although, in periods of sustained, high volume, an ATM can, over several days, raise surprisingly large amounts of capital). In addition, there is the administrative requirement of "bringing down" the program each quarter. Issuers should also be mindful that sales under an ATM program cannot be made while they are in possession of material nonpublic information unless it is conducted pursuant to a 10b5-1 program.

Issuers across a variety of sectors have utilized ATM programs in creative ways to finance their operations. For example, many life sciences companies use ATM programs to cover operating expenses and serve as a bridge between more significant capital raising events tied to the announcement of clinical trial results. Sector-specific innovations have also taken hold, such as the use of forward purchase agreements and preferred stock ATM programs in the case of real estate investment trusts (REITs).

While an ATM program can be difficult to implement during periods of extreme market volatility, they are possible in plateau periods of relative calm.

**PIPEs**

A Private Investment in Public Equity (PIPE) is a sale of a public company's equity or equity-linked securities made to select investors on a private placement basis. Pursuant to purchase agreements directly with the issuer, investors agree to purchase a fixed number of securities at a fixed price, and the issuer undertakes to register such securities (or underlying securities in the case of convertible securities) after closing prior to an agreed date so that they may be resold by such investors into the public market. PIPE transactions may be used to sell common or preferred stock, warrants, convertible debt and other types of equity-linked securities. One or more investment banks, in the role of placement agent(s), may act as a financial intermediary, connecting the issuer with interested investors, although many PIPE transactions do not involve broker-dealers or financial advisors. Secondary sales by selling security holders may also be structured as PIPEs, with the issuer's cooperation.

As a cost-effective and efficient financing type, PIPEs can offer an attractive alternative to traditional underwritten offerings during turbulent times. They often provide greater flexibility for a tailored structure as investors and the issuer negotiate deal terms directly. A PIPE can be completed quickly, perhaps in as little as a few days, depending on the due diligence period and disclosure document required by the investors and the placement agent (typically minimal given the issuer's publicly-filed reports), and the type of marketing undertaken. In addition, because most PIPE transactions are not disclosed publicly until a purchase agreement is signed, an issuer can privately explore the feasibility of a transaction and indicative pricing. This can allow an issuer to avoid the risk of downward pressure on its stock that may otherwise result from the public announcement of an impending transaction, particularly where pricing is expected to be dilutive. If a company is ultimately unable to come to terms on a PIPE transaction, it can explore alternatives confidentially. In addition, the placement agent or agents can keep the identity of the issuer confidential as they approach investors such that investors are not restricted from trading until they are brought "over-the-wall".

Downsides of PIPE transactions for issuers include that the securities may be offered only on a private placement basis, and are typically sold at a discount to the market price and sometimes with warrant coverage. In addition, companies must be mindful that if they intend to issue greater than 20% of their total common stock or voting power at a price that is less than the Minimum Price (as defined by Nasdaq Listing Rule 5635(d) and Section 312.02(c) of the NYSE Listed Company Manual, respectively), other than in a "public offering," as defined by the stock exchanges, they must first obtain shareholder approval before the shares of common stock are issued, which may impact the timing or the structure of the transaction. Further, both Nasdaq (in Nasdaq Listing Rule 5635(b)) and the NYSE (in the NYSE Listed Company Manual Section 312.02(d)) require shareholder approval when a new issuance results in a "change of control," as such term is defined by each stock exchange.

PIPE investors have historically been funds and other institutions with relatively short-term investment strategies. However, in 2008 and 2009, there was a significant increase in activity by private equity funds looking for alternatives to large leveraged transactions and venture capital funds that were able to negotiate PIPE transactions on terms more similar to those of their typical investments. Particularly when these funds acquired large equity stakes, they were able to negotiate governance rights, including board seats, observer rights and information rights. With today's market dislocation, funds and other institutional investors may find attractive opportunities to invest in public companies in need of equity capital infusions through a PIPE transaction.

Similarly to ATM offerings, PIPEs should be possible in periods of moderate volatility and during plateau periods even in the context of more extreme volatility.

**Registered direct offerings**

A registered direct offering (RDO) is a negotiated sale by an issuer directly to one or more investors of securities that have been registered pursuant to an already-effective shelf registration statement on Form S-3 or via a deal-specific registration statement establishing the RDO. An RDO is similar to a PIPE transaction, except that the sale of securities has already been registered at the time of issuance rather than after the issuance. Similar to underwritten offerings, the registered securities sold in an RDO generally have no initial restriction on resale, provided they are not sold to an affiliate. RDOs typically are for common stock, although issuers may sell other types of securities (e.g., convertible notes or warrants), including in combination.

Issuers typically appoint one or more investment banks to identify investors and act as placement agent in the offering. Unlike a firm commitment underwritten offering, an RDO is typically conducted by the placement agent on a “best efforts” basis. The placement agent targets a small number of potential investors that are particularly well-suited for a specific issuer, industry sector and offering profile. Targeted investors often include an issuer’s existing institutional shareholders, other institutional shareholders of the issuer’s comparable group of companies and/or certain institutional investors that regularly purchase securities in RDOs. By interposing a placement agent between the issuer and investors, the identity of the issuer can be kept confidential until an investor is brought “over-the-wall” thereby restricting the prospective investor, so that the investor is restricted from trading in the issuer’s securities until the offering is completed or terminated.

The mechanics of an RDO may present issuers and investors with important advantages over other forms of financing, particularly in volatile markets. For example, RDOs typically are marketed confidentially, without any prior public announcement of the offering. Similar to a PIPE, this allows an issuer and its placement agent to gauge the market's interest in a financing without the downward pricing pressure that often accompanies an announced public offering. RDOs typically are marketed based only upon an issuer's existing public disclosure, saving time and issuer resources. The securities purchased in RDOs are registered, which provides immediate liquidity (subject to market conditions) that is of importance to many investors. This advantage also runs to the issuer insofar as a registered offering allows the issuer to avoid the sometimes steep discounts to market price that can accompany PIPE offerings. Accordingly, the RDO process provides eligible issuers with a fast, confidential and efficient financing alternative, while providing investors a managed transaction and a liquid security.

While RDOs provide numerous advantages for public companies over other forms of capital-raising structures, they involve a number of important business and legal issues not encountered in PIPE offerings or traditional firm commitment underwritings. Although RDOs are not underwritten and may be marketed similarly to PIPE offerings, they are registered offerings, and the placement agent or agents have the potential for underwriter liability under Section 11 of the Securities Act, carrying significant civil penalties. Issuers and placement agents conducting registered direct offerings should also be mindful of the stock exchange requirements for shareholder approval discussed with respect to PIPEs. While an RDO is by definition a public offering under the federal securities laws, Nasdaq nevertheless may treat it as a private placement depending upon how widely and in what manner it is marketed, thereby potentially triggering the 20% issuance rule noted above. While the NYSE does not provide formal guidance on this topic, similar precautions should be taken if an issuer anticipates offering and selling a number of shares that could exceed 20% of total shares or voting power outstanding prior to the offering. The amount of capital a small cap issuer can raise in an RDO may also be limited by the "baby shelf" form requirements. Finally, since RDOs are not generally widely marketed to investors, they may not be effective equity capital raising tools for all issuers.

**Equity Line Financings**

In a typical “equity line” financing, an investor and the issuer enter into an equity purchase agreement providing the issuer with the right to put its securities to the investor. The equity line agreement typically sets forth, among other terms, the aggregate dollar amount of the investor’s total commitment and specified limits on the issuer’s ability to draw down on the equity line and put its shares to the investor. The purchase price of the securities in a particular put is generally determined by a formula tied to the market price of the shares over a pricing period.

In many equity line financings, just as in the PIPE context, an issuer will rely on a private placement exemption from registration to sell the securities to one or more accredited investors, and then register the resale of the securities that are privately placed. Equity line financings may also be conducted as registered offerings off of an existing or newly effective shelf registration statement. Small cap issuers subject to the “baby shelf” limits may be limited in their ability to conduct an equity line as a public offering, in which case the private equity line may be a more attractive structure. Equity line financings provide an issuer flexibility to pick the timing of equity sales if its capital needs are unpredictable in the immediate future, while also allowing it to avoid trough periods during market volatility.

Click here for a summary overview of certain alternative equity offering types that public companies may consider in addressing their funding and liquidity needs in light of volatile markets.

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Proskauer is a trusted advisor to issuers, sponsors, investors and investment banks in a broad range of equity capital markets transactions including ATMs, PIPEs, RDOs and Equity Line Financings. If you have questions or would like more information about accessing the equity capital markets, please contact your Proskauer attorney or one of the Capital Markets attorneys listed on this alert.

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