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Third Edition

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Preface to First Edition

For some people, the term "exempt offering" still tends to convey the impression of a transaction that is, in some respects, neither commonplace nor important—nor, for that matter, all that interesting. To understand this perspective, one need only go back about thirty years when exempt transactions tended to be relatively small common stock offerings for less established (often less creditworthy) issuers than those that would be typical candidates for public offerings. It was generally understood that exempt transactions were either a step along the path to becoming a public company, or a default financing for public companies that would not be well received in the public markets. Venture capital financings comprised the lion's share of this capital raising activity. This has all changed. Exempt and hybrid transactions are today among the key financing methodologies in the U.S. capital markets. If that were not the case, it is unlikely that you would want to read this book, or that we would have wanted to write it.

There are a number of factors that have contributed to the increasing significance of exempt transactions. For the most part, issuers are waiting longer to go public in the United States. This is due, in part, to the now commonly held view that larger companies, with more visible and predictable earnings trajectories and higher market capitalizations, make better public companies and will have securities that trade better in the public markets.

Several other factors are commonly cited for contributing to the decision to either delay or forego an initial public offering in the United States. One is the high cost of SEC compliance in the post-Sarbanes-Oxley world. According to the *Financial Times*, the average Fortune 1000 U.S. public company spent $5.1 million on implementing the changes required by Sarbanes-Oxley and now spends approximately $3.7 million on annual Sarbanes-Oxley compliance. Many privately held companies that can bear this cost are deterred from becoming public by the rise in security holder class-action litigation and by securities laws reform that has resulted in "criminalizing" a range of securities laws infractions that formerly were treated as civil matters. Litigation is invariably expensive.

When a company goes public, it loses a measure of operating flexibility, because it is thereafter required to report earnings on a quarterly basis. The pressure to produce earnings that will satisfy research analysts and institutional investors often tilts the corporate

decision-making process in the direction of favoring short-term results over more strategic, long-term initiatives. Sarbanes-Oxley brought significant limitations on executive compensation arrangements that are permissible for public companies. It is easy to see why this might create enthusiasm on the part of senior executives of successful private companies to defer going public for as long as possible. Their companies are likely to continue to finance in the private markets.

In the last few years, becoming a U.S. public company is considered much less important among foreign issuers. It is clear that it is no longer the same status symbol or imprimatur of success. For some, interest in the U.S. public markets has been supplanted by foreign securities exchanges and markets that now offer real trading depth. But for most, concern about the costs associated with being a U.S. reporting company, fears associated with Sarbanes-Oxley compliance, and recognition that the private markets have become much more significant in the United States, have been the determining factors in remaining privately held or avoiding becoming U.S. reporting issuers.

For existing U.S. public companies, similar considerations have influenced their decisions to seek exempt or hybrid transactions that combine elements of exempt transactions with elements of public offerings. We discuss two of the best known forms of hybrid offerings—PIPE transactions and registered direct offerings—in chapters 13, 14 and 22 [Chapter numbers have since changed. See Table of Contents—Ed.]. When the public market window is either closed or only slightly open, exempt transactions and hybrid offerings become the transactions of choice. There are strong indications that we have arrived at a point when institutional investors either prefer to buy securities in exempt or hybrid transactions, or are at least indifferent to whether they purchase securities in either of these forms, or in an underwritten public offering. With the growth of hedge funds has come a sharp increase in demand for restricted securities. The increased maturity of the Rule 144A market and the advent of dark pools have done a great deal to broaden and deepen the market for restricted securities in the United States.

The adoption of Regulation FD, the SEC regulation that requires public companies to promptly disclose material information, coupled with the virtually instantaneous flow of information enabled by technological innovation, have left issuers concerned with whether satisfaction of the required public disclosure of the possibility of a public offering launch functionally locks them into proceeding with a financing. Public announcement of a potential financing typically exerts downward pressure on an issuer's stock price just as the marketing phase of the public offering process is getting underway. In short, an increasing number of public companies have determined that market dynamics have shifted in ways that make public offerings less certain and more risky than exempt transactions. Day traders,

momentum buyers, formula traders, the availability of equity derivatives, and the increase in stock borrow–stock loan activity have all contributed to this significant change.

For issuers that are temporarily unable to meet SEC requirements for a public offering for reasons that would not necessarily deter investor interest, exempt transactions are the obvious alternative. The generally lower time commitment and expense associated with executing an exempt transaction add to their attractiveness.

The continuing evolution of the securities laws and regulations has also contributed to the increase in exempt transactions by public companies. The shortening of the Rule 144 holding period has made exempt transactions more attractive to various categories of buy-and-hold investors. The adoption of Regulation S has provided much needed clarity concerning the availability of the extra-territorial exclusion from U.S. securities laws for unregistered offerings that are executed abroad. PIPE transactions were created in response to the regulatory change that made it possible for holders of restricted securities to publicly reoffer such securities under an abbreviated shelf registration statement.

An intriguing aspect of the increased popularity of exempt transactions is the coalescence of the processes for executing exempt transactions and registered transactions. Approaches to capital raising necessarily adapt to changing conditions and preferences in the marketplace. When we look at the changes in exempt transactions over the last five years, there is an unmistakable progression toward providing investors with enhanced liquidity in the near term. When we look at registered offerings over this same period of time, there is greater emphasis on "targeted" marketing or identifying large institutional investors prior to, or immediately upon, launching a transaction. For a variety of reasons, we think these trends are going to become more apparent—to the point where the distinctions between exempt and registered transactions will become a blur.

If we are correct in our forecast, then there will be an inevitable rethinking of the legal and regulatory standards for determining when offerings of securities must be conducted subject to SEC registration and when they may be conducted as exempt transactions. Until then, these decisions will continue to turn on highly fact-specific analyses that are not renowned for either consistency or intellectual purity. We address the need for this regulatory reform in chapter 11.

We would like to take this opportunity to thank our publisher, William Cubberley, and our editors, Carol Benedicto and Carmen Llamas, of the Practising Law Institute, whose patience and editing skill are appreciated and admired. Louis Rolla assisted with editing chores and offered valuable guidance for which we are thankful. We would also like to thank our many colleagues in the Capital Markets

group at Morrison & Foerster LLP who lent their assistance to this project. Our partner David Lynn warrants special recognition for his insightful comments and suggestions. We also thank our partners Brian Bates, Peter Green, Jeremy Jennings-Mares, David Kaufman, Lloyd Harmetz, Joel Haims, John Hempill, and Brandon Parris for their suggestions on particular chapters. We appreciate the contributions of our tax partners Thomas Humphreys and Shamir Merali, and tax colleagues Susan Glenn and Remmelt Reigersman who provided comments regarding the tax consequences associated with various financing transactions. Other colleagues also made enthusiastic and valuable contributions. In alphabetical order, they are Melissa Beck, Stephanie Birnbaum, Ze'ev Eiger, Mara Goldsmith, Julie Grundman, Michael Kalish, Joseph Magnas, Gerd Damsgaard Thomsen, and Lisa Wang. We give a special thanks to our colleague Nilene Evans for her many contributions. We thank Mara Goldsmith and Judd Roberts for their assistance with the sample documents and precedents that are included in the Forms Volume. We also thank Timothy Cleary who cheerfully undertook the grueling and often mind-numbing task of all of the cite-checking. And finally, we would like to acknowledge former colleagues and teachers, Lewis G. Cole, Melvin Epstein, and Carl Kanter, whose knowledge of, and fascination with, the federal securities laws was both inspiring and contagious. In any book of this size and scope, it would be unusual if there were no flaws, no omissions, or poorly chosen words. If, in the fullness of time, any of these reveal themselves or are revealed to us, each of us will say to the other, "My bad." And one of us will actually mean it.

ANNA T. PINEDO AND JAMES R. TANENBAUM
New York City
June 2009

Preface to Second Edition

This is the second edition of a treatise that we completed two years ago. We wrote the first edition because we believed that exempt and hybrid transactions were underappreciated and not always well understood. Since it was then clear, at least to us, that exempt and hybrid transactions had become, and were likely to become even more, significant capital raising alternatives, we determined that a comprehensive guide to the law, regulation, and processes relevant to such transactions would be welcome.

We've learned a few things since we wrote the first edition. It turns out that the financial crisis served to reinforce the need for companies to access the capital markets even during periods of extreme market volatility, and to do so efficiently. Exempt and hybrid transactions became even more important to many companies as they sought to raise capital and market conditions would not permit these companies to pursue traditional, fully marketed underwritten offerings. One might say that, once again, necessity drove innovation. During this period, very large, well-known companies secured new capital through PIPE transactions, precisely to avoid shorting activity in their stocks. We also were able to use at-the-market offerings for financial institutions, which needed to raise capital, but could not risk investor frontrunning. Finally, we also were able to apply the techniques associated with PIPE transactions and registered direct offerings to assist our clients with pre-marketed or "wall-crossed" offerings. These transactions serve to "blur" the lines between private and public some more . . . . These lines will not get sharper anytime soon.

Having emerged from the crisis period, as we now contemplate regulatory reform, market participants have questioned whether securities regulations have kept pace with technology and market structure changes. As we noted in the first edition, initial public offerings may no longer be the gold standard for many emerging companies. We continue to see an unmistakable progression toward providing investors with enhanced liquidity in the near term. This has led to the growth of many new "secondary market" opportunities for holders of securities of privately held companies. We discuss some of these new liquidity opportunities in this new edition. Following adoption of the Dodd-Frank Act, there also has been renewed focus on the effect of regulation on the competitiveness of our capital markets and on entrepreneurship and emerging companies. As attention in the United States has turned to promoting economic activity, the dialogue

related to regulatory burdens and their effect on capital formation has taken on a new sense of urgency. We discuss in this new edition a number of the principal measures that are being debated, including amending Regulation A, reexamining many of the requirements for conducting private placements, and implementing changes to the Exchange Act reporting requirements in order to permit smaller companies to stay private. We are hopeful that the experiences of the last few years will lead to private placement reform.

We would like to take this opportunity to thank our publisher, William Cubberley, and our editor, Carol Benedicto, of the Practising Law Institute. We would also like to thank our many colleagues in the Capital Markets group at Morrison & Foerster LLP. We give a special thanks to our colleague Nilene Evans for her many contributions. And, of course, as we have pointed out before, the best features of this treatise are the result of having excellent colleagues, and the imperfections are completely attributable to the limitations of one, and possibly both, of the authors.

ANNA T. PINEDO AND JAMES R. TANENBAUM
New York City
October 2011

Preface to Third Edition

Trends that we recognized as underway in 2009 when this treatise was first published are now, simply stated, well established. In the last twenty years, the number of companies with a class of equity securities listed on U.S. securities exchange has declined sharply. It has been roughly a 50% decline. The principal contributing factor in the reduction of listed securities has been robust M&A activity. It is also the case that during this period, the volume of initial public offerings has been relatively modest, at least by comparison to the prior decade. So, in 2017, initial public offerings tend to be larger, and listed companies tend to be bigger, older, and more profitable.

The impact of all of this on exempt transactions has been evident. Companies tend to remain private longer, the availability of capital through exempt transactions is, as a general matter, reliable, if not predictable, and valuations generally appear to be rational.

That said, efforts at regulatory reform such as the Securities and Exchange Commission's Disclosure Effectiveness initiative and other changes that reduce the cost of going and remaining public are worthy of close attention. It may be, when their impact is fully felt, that the pendulum may swing in the other direction, going public may become more attractive, and remaining private, less so. While reforms like the Jumpstart Our Business Startups (JOBS) Act have been very well received by securities lawyers and a variety market participants, the consolidation of investment banks, the high cost of providing research analyst coverage for smaller companies, and the growth in size and significance of institutional investors that are limited to investing in larger cap companies, are factors that can be expected, unfortunately, to mitigate the impact of reforms like the JOBS Act or efforts at regulatory burden reduction.

So, we will wait and see. And in the meantime, we will keep our exempt offering materials close at hand. We wish to thank our colleagues, including Brian Bates, Ze'ev Eiger, Carlos Juarez and Jared Kaplan, for their assistance.

ANNA T. PINEDO AND JAMES R. TANENBAUM
New York City
June 2017

Introduction

This treatise is intended to serve as a practical resource for both practitioners and their clients. We have organized it into three parts: Part I, "Regulatory Framework"; Part II, "Conducting an Exempt or Hybrid Offering"; and Part III, "Other Regulatory Matters."

PART I
Regulatory Framework

Part I provides a brief overview of the regulatory framework applicable to exempt securities offerings and discusses the most commonly used exemptions from the registration requirements. In addition, we discuss the shelf registration process, and the changes to the regulation of securities offerings that have facilitated capital formation. These regulatory changes have given issuers greater certainty in conducting exempt offerings and increased flexibility in conducting shelf takedowns. Together, changes to the private offering process and the registration of securities have made it possible to develop many more securities offering methodologies that take the best of both worlds—elements of private and registered offerings.

Chapter 2 provides an overview of the most frequently used private placement exemptions. We focus principally on section 4(a)(2) and the Regulation D safe harbor. We also discuss other exempt offering exemptions, such as the exemption for intrastate and regional offerings.

Chapter 3 discusses Rule 506 under Regulation D, which is the most frequently used of the safe harbors under Regulation D. Given the changes brought about by the JOBS Act mandate to relax the prohibition against general solicitation in the context of certain Rule 506 offerings, this chapter provides some background regarding the types of communications that constitute a "general solicitation," as well as the conditions for reliance on Rule 506.

Chapter 4 discusses the application of the section 4(a)(1) exemption to transactions by any person other than an issuer, underwriter, or dealer, and the practical issues arising with reliance on section 4(a)(1) in the context of control securities. We also discuss the concept of section 4(a)(1½), as well as the codification through the FAST Act of a limited resale exemption, section 4(a)(7), which is similar in certain respects to section 4(a)(1½).

Chapter 5 discusses exemptions available to dealers and to brokers under section 4(a)(3) and section 4(a)(4), respectively, for their securities transactions.

Chapter 6 discusses the Rule 144 safe harbor for the resale of restricted securities. In addition to reviewing the conditions for availability of the safe harbor, we also discuss the various amendments to Rule 144 culminating in the 2007 amendments that, among other things, shortened the applicable holding periods.

Chapter 7 explains Rule 144A, which provides a non-exclusive safe harbor from the section 5 registration requirements to persons, other than the issuer, for the resale, in a transaction not involving a public offering, of certain securities only to persons reasonably believed to be QIBs.

Chapter 8 introduces the exclusion from the registration requirements permitted by Regulation S for offshore offerings.

Chapter 9 discusses Rule 701, which provides an exemption from the registration requirements for securities issued by non-reporting companies as compensation. In the absence of the specific Rule 701 non-exclusive safe harbor, issuers offering employees stock-based compensation would have to find another exemption from the registration requirements.

Chapter 10 discusses the concept of shelf registration. A shelf provides an issuer with the flexibility to pursue any number of financing opportunities, including a block trade, a bought deal, an overnight deal, a registered direct offering, an at-the-market offering, or a continuous issuance program.

Chapter 11 summarizes the 2005 SEC changes to the registration, communication, and offering processes for issuers, referred to as Securities Offering Reform. While Securities Offering Reform provides the greatest benefits to larger public companies, by making it more efficient for these companies to offer securities in registered offerings, the changes also affect exempt and hybrid offerings. An automatically effective shelf registration in practice achieves many of the same benefits achieved through an exempt offering. The SEC also amended many of the regulations applying to communications and provided additional communications related safe harbors. For exempt offerings, these safe harbors are important in order to avoid having certain communications deemed to constitute a "general solicitation."

Chapter 12 provides an historic perspective on the regulation of exempt offerings. We identify the sources of ambiguity and inefficiency associated with exempt offerings. These should not be viewed as impediments to exempt offerings, but rather as structuring considerations for issuers and financial intermediaries and their advisers when contemplating an exempt financing.

Chapter 13 addresses the issues that arise for companies that choose to defer becoming a public company. The discussion examines the challenges associated with a company that chooses to stay private longer, and relies on successive exempt offerings to fund its growth.

PART II
Conducting an Exempt or Hybrid Offering

Part II is intended to provide a "how-to" for each type of offering discussed. We tend to think of financing transactions as existing in a continuum—the liquidity continuum. We start with transactions that are the least liquid and work through to those that are the most liquid.

Chapter 14 provides a brief overview of venture capital financings. For most companies, a venture round remains a rite of passage. There are many excellent treatises, including some written by our partners, that focus exclusively on venture finance and the intricacies of financing emerging companies. As noted above, in recent years there have been new entrants into the private equity landscape, including hedge funds, funds of funds, private equity funds, sovereign wealth funds, and leveraged buyout funds. These new participants have tended to follow venture precedents in structuring their investments in private companies. In another example of the "melting pot"/blurring of lines, many of these private equity investors have imported features of venture deals when making private investments in already public companies. Thus, we offer a summary of basic venture capital transactions as the starting point for our liquidity continuum.

Chapter 15 discusses the traditional PIPE transaction, which we created in 1985. Since then, traditional PIPE transactions have evolved and have been used in a variety of different (often unanticipated) ways by already public companies as a financing alternative when the public markets were either unattractive or unavailable.

Chapter 16 discusses structured PIPE transactions. Structured PIPE transactions generally are structured as private placements with trailing (or follow-on) resale registration rights. The issuer usually commits to register the common stock that is issued at closing, or that underlies the convertible securities issued at closing, for resale shortly after closing, which is generally within three business days of the execution and delivery of the purchase agreements. The transaction involves the issuance of securities at a fixed or variable price, and involves the issuance of common stock with warrant coverage, convertible securities, or secured debt.

Chapter 17 discusses the questions and issues associated with PIPE transactions and new permutations that have evolved since we first created PIPE transactions. We also discuss the SEC Staff's guidance regarding a number of interpretive questions relating to PIPE transactions.

Chapter 18 discusses the process for conducting an institutional private placement of debt securities. An institutional debt private placement is an offering of debt securities made to investors in the United States in reliance on section 4(a)(2) of the Securities Act.

Reporting issuers rely on institutional private placements as an alternative to a registered offering. Many privately held companies or foreign issuers that do not want to subject themselves to U.S. reporting requirements have also come to rely on these offerings as an important source of capital.

Chapter 19 provides guidance on structuring and conducting a Rule 144A offering, a Regulation S offering, and a combined Rule 144A/Regulation S offering.

Chapter 20 discusses the process for conducting shelf takedowns, including the necessary SEC filings, documentation, and different securities offering methodologies. The chapter also addresses bought deals and confidentially marketed public offerings.

Chapter 21 discusses registered direct offerings and equity lines of credit. These securities offering methodologies are sometimes referred to as "hybrid" offerings, because they combine certain traits of both registered follow-on offerings and private placements. Both types of transactions generally are structured and marketed in a manner similar to that employed for private placements.

Chapter 22 discusses continuous issuance programs, which enable a larger, more established issuer that has regular funding needs to maximize its capital raising opportunities.

PART III
Other Regulatory Matters

Part III describes all of the other regulatory issues that may arise in connection with exempt and hybrid offerings. In this part, we focus on all of those regulations that an issuer or a practitioner may think of as being applicable only in the context of a traditional registered follow-on offering. We also devote a fair bit of time to hedging transactions.

Chapter 23 focuses on the communications and disclosure issues that arise in connection with exempt offerings (whether conducted by private companies or reporting issuers) and hybrid offerings. In connection with exempt offerings, communications concerns arise principally in three instances. First, in order to establish the availability of an exemption from registration, the issuer must carefully consider its communications with potential offerees. Second, once an issuer has established the availability of an offering exemption, the issuer must consider the information that it will share with potential offerees. Third, particularly for reporting issuers, the issuer must consider the circumstances under which it will share information with potential offerees (that is, subject to a non-disclosure or confidentiality agreement) in an exempt or hybrid offering.

Chapter 24 provides guidance for using electronic communications. The SEC recognizes the utility of the Internet in conducting securities

offerings. However, much of the SEC's guidance on the use of the Internet and electronic communications for exempt offerings still relies on pre-Internet notions relating to "offers" and the "solicitation of offers"—anachronistic concepts. As a result, even following the JOBS Act, there is still a fair bit of ambiguity and tension inherent in using the Internet for an "exempt" offering, in which the basis for the exemption from registration depends squarely on the limited nature of the offering.

Chapter 25 discusses Regulation A, as well as the amendments to Regulation A, often referred to as "Regulation A+," that resulted following the JOBS Act. Although Regulation A provides an exemption from the Securities Act section 5 registration requirements, the rule sets out a framework for a smaller public offering. Regulation A is not a "private placement" exemption, but is a likely capital-raising alternative for smaller companies.

Chapter 26 provides an overview of the legal and regulatory issues arising in connection with crowdfunded offerings, which must be conducted entirely through the Internet. We discuss the exemptions from the registration requirements that were available for crowdfunded offerings prior to the adoption of the final Regulation Crowdfunding, required by the JOBS Act, as well as the final rules adopted by the SEC.

Chapter 27 discusses safe harbors from integration and other integration issues, including questions of private and public offerings conducted in close proximity.

Chapter 28 addresses the federal statutory bases for the liability of issuers, financial intermediaries, selling security holders, and other participants in securities offerings, including exempt offerings. We also discuss available defenses to such liabilities and other steps offering participants may take that can result in successful offerings without triggering third-party liabilities.

Chapter 29 discusses the use of "big boy" letters. In a private placement, a traditional or structured PIPE transaction, a Rule 144A offering, or other exempt offering, an issuer and its financial intermediary may share material nonpublic information with certain sophisticated investors pursuant to the terms and conditions of an agreement known as a "big boy" letter.

Chapter 30 addresses the role of FINRA and the national securities exchanges in private placements and other exempt offerings that are subject to their rules. The SEC has delegated part of the responsibility for enforcing securities laws to various self-regulatory organizations. These include FINRA, as well as the various securities exchanges.

Chapter 31 focuses principally on the application of Regulation M to exempt and hybrid offerings. Regulation M is intended to protect the trading markets by prohibiting distribution participants from undertaking certain actions in connection with or during a securities

offering that could manipulate the market to benefit those securities. An offering may be an exempt offering, but not necessarily exempt from the application of Regulation M.

Chapter 32 discusses the requirement under section 4(a)(2) that an investor in a private offering must purchase the securities with investment intent. The chapter also discusses scrutiny by the SEC of hedging transactions entered into in connection with PIPE transactions and other private placements. The SEC has brought a number of enforcement actions against hedge funds, their advisers, and managers in connection with improper shorting activities, which may have constituted unregistered public sales of securities.

Chapter 33 reviews the transactions that may subject an investor to reporting requirements, because, as a result of the investor's significant ownership interest, the investor may be rendered an affiliate or control person of the issuer. This chapter also discusses the requirements that may become applicable upon the occurrence of a change in control.

Chapter 34 discusses private placements in connection with acquisitions, including Rule 145 considerations.

A word of caution about the thirty-four chapters that follow: We have seen more significant change in the regulation and execution of financing transactions during the last fifteen years than in the entirety of our legal careers. This text will be updated from time to time to reflect future changes. Readers are urged to keep in mind that this book should be viewed as a somewhat static treatment of topics that are, by their nature, highly dynamic and prone to change.

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New York City
September 2017

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CONDUCTING AN EXEMPT OR HYBRID OFFERING

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