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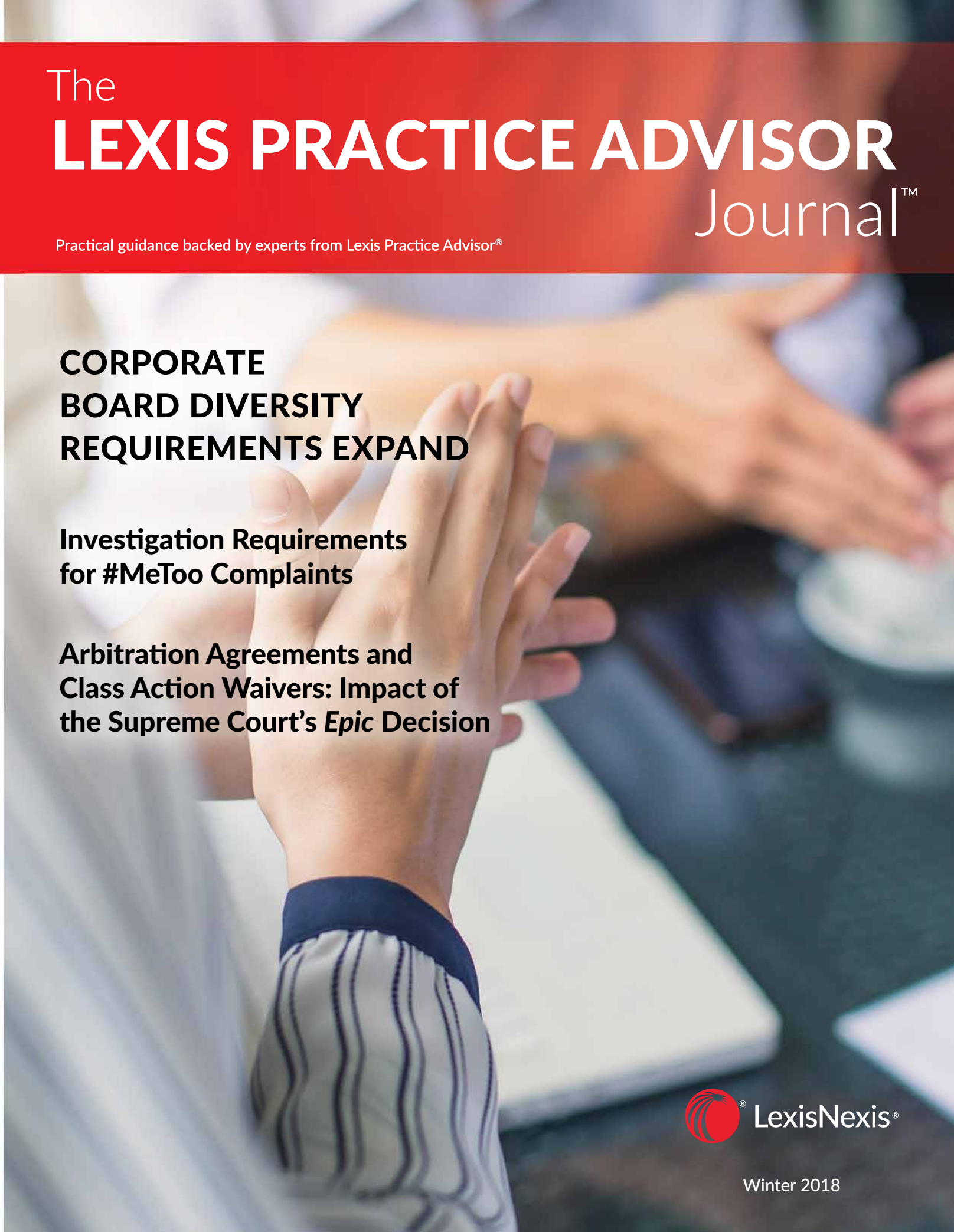

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Top 10 Practice Tips: **Secondary Offerings**

THIS ARTICLE COVERS 10 PRACTICAL TIPS THAT COUNSEL in a secondary offering can use to facilitate execution and avoid common pitfalls. Secondary offerings of equity securities by stockholders of public companies are one of the more frequent capital markets transactions. However, many secondary offerings are conducted on short notice and transactions can take a number of different forms, based on the nature of the issuer, the selling stockholders, and the securities being sold. The transaction itself is also subject to a number of regulatory and logistical challenges and may have a significant impact on the post-transaction governance and ownership of the issuer going forward, all of which must be addressed at the outset. Practitioners representing issuers, selling stockholders, or underwriters should familiarize themselves with the structure of the offering in advance. The following practice tips highlight some of the most crucial issues to be aware of and plan around.

1 Determine which registration statement to use.

It is critical to understand which type of Securities and Exchange Commission (SEC) registration statement form the issuer is eligible to use and what that means for the timing of an offering. For the first 12 full calendar months after an initial public offering, a domestic issuer will only be eligible to use Form S-1. Registering shares on Form S-1 can add significant time to the process, as a Form S-1 typically takes more time to draft than the other forms and is also subject to SEC review and comment, although the SEC will sometimes decline to review or give an expedited review of a Form S-1 for a secondary offering. Twelve full calendar months after an initial public offering, assuming the issuer has made all required filings under the Securities Exchange Act of 1934, as amended (Exchange Act), the issuer may be eligible to use Form S-3. If the issuer does not qualify as a well-known seasoned issuer (WKSI), the Form S-3 will be subject to SEC review. However, declined and expedited reviews by the SEC are more common in the context of a Form S-3. If the issuer qualifies as a WKSI, the Form S-3 will be automatically effective, bypassing SEC review altogether. Conversely, if the issuer has a public float of less than $75 million, the resale of securities via a Form S-3 is limited to sales of no more than one-third of all equity held by non-affiliates over the prior 12 months (otherwise known as a baby-shelf).

2 Control the communications.

Public communications by the issuer and the selling stockholders must be carefully monitored during a secondary offering, as each will be anxious to make public announcements about secondary offerings. Any communication by the issuer or a selling stockholder during the offering must be evaluated to determine whether it is a free writing prospectus. If it is a free writing prospectus, it must then be determined whether

it needs to be filed with the SEC. The rules regarding free writing prospectuses can be complex and require careful consideration by counsel. A best practice is for issuer counsel to make it clear to the issuer and the selling stockholders that all public communications must be reviewed by counsel prior to being released.

3 Be prepared in a block trade process.

The process for a block trade varies depending on the particular transaction. However, a typical process is that a bid is selected immediately after markets close. The issuer must then immediately issue a press release on the block trade so that the bank can begin to resell shares to its clients. There is often a preliminary prospectus or prospectus supplement in a block trade, but not always. In block trades, there is typically immense timing pressure after the winning bid is selected as the bank will be anxious to begin reselling. It is key for counsel to be prepared for all possible winning bids. There may be one underwriter or multiple underwriters and the re-offering by the banks may be at a fixed price or at variable prices. Counsel should be prepared for all possibilities to avoid delaying the offering.

4 Consider the effect of existing agreements.

A selling stockholder will often require the issuer to register its shares under a registration rights agreement. Counsel must check the agreement to ensure full compliance with its requirements. Often there will be other large stockholders with "piggyback" registration rights. Such rights will typically require delivery of notice to stockholders with these rights, who will have the right to sell shares on the same terms as the selling stockholder initiating the process. This can significantly impact the timing of secondary offerings, including whether a block trade is feasible. In addition, large stockholders frequently have one or more nominees on the board of directors of the issuer, subject to holding a specified

percentage of shares. Always check the underlying agreements to confirm whether a selling stockholder is losing the right to nominate directors to the board.

5 Keep public disclosure current.

If there have been any material developments for the issuer that have not been disclosed, a recent developments section should be included in the offering materials. If a fiscal quarter has ended prior to the offering, depending on timing, a bank will likely ask for so-called flash numbers, which are typically a range of projected results for the quarter. Other developments that may require disclosure include updates to material litigation, recent acquisitions, or other significant events. If an issuer is contemplating a material acquisition that cannot be made public at the time of the proposed offering, carefully consider whether the offering can proceed at that time. This will depend on how advanced the negotiations are and the significance of the acquisition to the issuer.

6 Confirm that the offering will take place during an open trading window.

In addition to any issuer blackout periods as a result of an offering occurring prior to the release of financial results or other material information, an issuer's ability to register shares and the selling stockholders' ability to sell shares may be impacted by existing lock-up agreements as a result of a prior capital markets offering. If a waiver of a lock-up agreement with an underwriter in a prior offering is required, you should consider whether such underwriter would then need to be included in the proposed offering as well. Finally, the timing of sales by selling stockholders should also be evaluated against any prior acquisitions of shares, including transactions not exempt under Rule 16b-3[1] of the Exchange Act, so as to not trigger any short swing profit liability.

7 Get the logistics right.

Understanding how the shares to be sold are held is critical to an efficient closing, particularly with the shortened "T+2" settlement cycle. While many shares are held in book-entry form, if the shares are held in certificated form, they will need to be transferred back to the issuer's transfer agent. In addition, if that stockholder will continue to hold shares in certificated form, a new certificate will need to be issued. If the shares are held in street name (i.e., with a broker), then arrangements will need to be made with the broker to transfer the shares to the transfer agent prior to closing. And for shares that will be sold pursuant to the exercise of options, the timing and structure of such exercise (cash—prior to the offering or with the proceeds from the offering—or cashless) will need to be coordinated with the issuer and the underwriters. In all situations, appropriate documentation will need to be cleared with the transfer agent, including any documentation such as stock powers or resolutions that require a medallion guarantee (which may be difficult for foreign entities to obtain). If there are more than a handful of selling stockholders, the underwriters may also require each selling stockholder to execute a power of attorney and custody agreement, so as to efficiently deliver shares at closing.

8 Pay attention to underwriter rules and requirements.

Underwriters and their counsel must be aware of Financial Industry Regulatory Authority (FINRA) filing obligations in connection with the offering and any restrictions on the issuance of research reports prior to the offering. For FINRA, counsel should note the different standard used as compared to the SEC's definition of a seasoned issuer. If a published research report does not fit within the permitted exceptions under Rules 138[2] or 139[3] of the Securities Act of 1933, as amended, the underwriter may be forced to leave the syndicate. As such, underwriters' counsel must communicate to clients early on the need to refrain from engaging in such activity until the completion of the offering.

9 Evaluate key legal issues.

Counsel representing the issuer and selling stockholders must consider certain legal issues, particularly with respect to the underwriting agreement. The representations and warranties given by the issuer, and the indemnification coverage, should be reviewed and discussed with management to ensure there are no problematic issues and that there is consistency with public disclosure. The representations and warranties given by the selling stockholders should be appropriately limited in scope to matters over which such stockholders have responsibility. For example, indemnification with respect to disclosure should cover no more than the limited information required under Regulation S-K to be included in the prospectus about the selling stockholder, and a "clean-hands"-type representation, particularly by an affiliate of the issuer, must be carefully considered. In addition, the duration and coverage of individuals (beyond the selling stockholders) under any lock-up agreement will need to be negotiated and evaluated in the context of future offering and transfer plans, as well as execution of the contemplated offering. In particular, issuer and selling stockholders' counsel should carefully review

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1. 17 C.F.R. § 240.16b-3. 2. 17 C.F.R. § 230.138. 3. 17 C.F.R. § 230.139.

Related Content

For a discussion about the various legal opinions customarily delivered by attorneys for offerings of securities, see

> LEGAL OPINIONS FOR SECURITIES OFFERINGS

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Practice Notes*

For a review of the federal liability provisions applicable to disclosures made in security offerings, see

> LIABILITY UNDER THE FEDERAL SECURITIES LAWS FOR SECURITIES OFFERINGS

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Practice Notes*

For guidance on the preparation of the Form S-1 registration statement to be filed with the SEC, see

> FORM S-1 REGISTRATION STATEMENTS

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Practice Notes*

For an overview of the role of underwriters in registered securities offerings, see

> UNDERWRITING REGISTERED SECURITIES OFFERINGS

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Practice Notes*

For a guide to permissible communications by issuers in connection with registered securities offerings, see

> SEC COMMUNICATIONS RULES FOR ISSUERS IN REGISTERED OFFERINGS (CHART)

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Checklists*

For a list of management due diligence questions for use by counsel to conduct interviews with the issuer's management, see

> MANAGEMENT DUE DILIGENCE QUESTIONS

RESEARCH PATH: *Capital Markets & Corporate Governance > Secondary Offerings and Resales > Secondary Offerings > Forms*

the lock-up agreement carve-outs to ensure that anticipated transactions, such as sales under existing Rule 10b5-1 plans and transfers to affiliates, are permitted during the lock-up period. Finally, counsel to both the issuer and selling stockholders will need to assess the need to engage local counsel for opinions to be delivered to the underwriters at closing. For entities organized in foreign countries or states other than Delaware or New York, special attention should be paid to ensure that the requisite opinions can be delivered on the contemplated timeline.

10 Think ahead to post-offering.

Prior to the launch of the offering, both the issuer and selling stockholder must understand how the potential sale in the offering will impact the governance of the issuer. For example, many institutional stockholders have director designation, voting, and other rights tied to specific ownership levels of the issuer. In certain cases, stockholders may not only lose designation rights, but a current designee may be forced to resign upon completion of the transaction. In addition, an issuer must be aware of whether the sale will affect its reliance on stock exchange-controlled company exceptions applied to the composition of its board of directors and committees. To the extent the transaction would result in an issuer falling below such controlled company status, contingency plans must be made in advance to avoid falling out of compliance. These matters are not just important for corporate planning purposes, but they will also need to be disclosed in the prospectus supplement filed with the SEC immediately prior to launching the offering.

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