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# TOP 10 PRACTICE TIPS: REGISTERED DIRECT OFFERINGS

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A registered direct offering (RDO) is a public offering of securities that is sold on a best efforts basis by a placement agent that is engaged by the issuer to introduce the issuer to potential purchasers. An RDO is generally targeted to a select number of accredited and institutional investors, although it may be sold to non-accredited investors. Issuers find RDOs an attractive option when they are seeking to test the market or conduct an offering without attracting much market attention. Below are 10 practice points relating to RDOs.

## 1. UNDERSTAND THE BENEFITS OF AN RDO

RDOs are private style public offerings that have characteristics of both public and private offerings. An RDO is a placement of registered securities pursuant to an issuer's effective registration statement and the securities are freely transferable. RDOs are generally sold to a limited number of institutional investors, however, as an RDO is a public offering, it can also be widely sold, including to retail investors. An RDO's targeted marketing, which is similar to the marketing approach employed in a private placement or a private investment in public equity (PIPE) transaction, makes it attractive to issuers that want to test the market or conduct an offering without attracting publicity. When an issuer has an effective shelf registration statement, the placement agent may market a potential RDO by obtaining confidentiality undertakings and approaching investors on a wall-crossed basis until an actual transaction is announced. This confidential marketing allows an issuer to test the market without exposing its stock to speculative trading that often accompanies a fully marketed follow-on offering. The issuer would announce the transaction immediately prior to pricing or at pricing of the RDO. In addition, an RDO allows an issuer to achieve a public offering pricing with no liquidity discount while maintaining the relative confidentiality of a private placement because investors receive registered, freely transferable securities. To the extent that the issuer is seeking a more broadly marketed offering, an RDO may not be the best choice.

## 2. ENSURE THAT THE BOARD OF DIRECTORS AND THE PRICING COMMITTEE UNDERSTAND THE STRUCTURE OF THE RDO.

An RDO is a best efforts placement of securities. The placement agent will not be required to purchase, and cannot purchase, any of the offered securities and thus will not need to use its capital. In addition, the placement agent cannot engage in market stabilizing transactions for the RDO and can only engage in passive market making activities. An RDO does not include an over-allotment option, which is principally used for market stabilization in connection with firm commitment offerings and is not applicable to an RDO. To meet additional demand, an issuer can increase the RDO's size. However, the issuer should understand that, to the extent its stock is volatile, the placement agent does not have the option of engaging in stabilization activities nor can it exercise an over-allotment option for this or any other purpose.

## 3. CONSIDER THE BEST STRUCTURE FOR THE RDO AND WHETHER AN ESCROW ACCOUNT REQUIREMENT IS APPLICABLE

An RDO can be structured in any of the following ways: (i) on an all or nothing basis, in which case all the securities must be sold in order to close the transaction, (ii) on a minimum/maximum basis, in which case a minimum number of securities must be sold in order for the transaction to close, or (iii) on an any or all basis, in which case the transaction will close without a minimum threshold for the number

of securities sold. Only in the cases of (i) and (ii), pursuant to Rule 15c2-4 of the Securities Exchange Act of 1934, as amended, the placement agent is required to set up an escrow account into which investor funds are collected and held until the conditions for release are met. An issuer may sell its own newly issued shares and selling stockholders may also sell secondary shares, either alone or with issuer primary shares, in an RDO.

## 4. REGISTRATION STATEMENT AND PROSPECTUS SUPPLEMENT

An issuer can conduct an RDO as a shelf takedown pursuant to an existing shelf registration statement or, if an issuer does not have an effective shelf registration statement, an issuer can file a registration statement for purposes of conducting the RDO. In the case of the latter, an issuer can file a bullet registration statement that is a single purpose registration or file a shelf registration statement. Once such registration statement is effective, the issuer would file a prospectus or prospectus supplement for the RDO. If the RDO is a takedown offering made pursuant to an existing shelf registration, the issuer will file a preliminary and/or final prospectus supplement for the RDO. An RDO is most efficient when the issuer already has an effective shelf registration statement, since, as noted above, one of the compelling attributes of an RDO is the targeted marketing.

## 5. NEGOTIATE THE PLACEMENT AGENCY AGREEMENT

An issuer and the placement agent(s) will enter into a placement agency agreement, which is the equivalent of an underwriting agreement in a firm commitment underwritten offering. The placement agency agreement generally will contain the following provisions: (i) exclusive retention of the placement agent to introduce investors on a best-efforts basis, (ii) issuer representations and warranties, (iii) issuer covenants, (iv) indemnification of placement agent and certain of its affiliates from liabilities arising in connection with the offering under the Securities Act of 1933, as amended, (v) the requirements for closing deliverables, including legal opinions, 10b-5 negative assurance letter from the issuer's counsel, and an auditor comfort letter, and (v) other customary closing certificates. To the extent that the issuer has undertaken an underwritten public offering in close proximity to the proposed RDO, the issuer representations and warranties and the covenants contained in the underwriting agreement from the prior offering may provide a good starting point for the draft placement agency agreement.

## 6. CONSIDER WHETHER SUBSCRIPTION AGREEMENTS WILL BE REQUIRED

An RDO generally will not involve individual purchase agreements, or subscription agreements, between the issuer and the purchasers. In certain cases however, hedge fund investors may request to have a separate agreement with the issuer or be added as a named third-party beneficiary to the placement agency agreement to have the issuer's representations and warranties in the placement agency agreement made to the purchasers. If there are subscription agreements in an RDO, the issuer must take care that such any such agreement is not deemed to constitute an offering related document, such as a free writing, and that it is not executed prior to the delivery of a Securities Act Section 10 compliant prospectus.

## 7. CONSIDER WHETHER THE RDO IS A PUBLIC OFFERING OR WHETHER IT IS SUBJECT TO THE 20% RULE.

If an issuer anticipates the offering amount in an RDO to exceed 20% of the total pre-transaction shares outstanding and such shares are to be sold at a discount, the issuer must determine whether it will need shareholder approval under the applicable securities exchange regulations. Under NYSE Rule 312.02(c), shareholder approval is required prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, if the common stock has, or will have upon issuance, voting power equal to or in excess of 20% of the voting power outstanding before the issuance, or the number of shares of common stock to be issued is, or will be upon such issuance, equal to or in excess of 20% of the number of shares of common stock outstanding before such issuance, unless (i) such public offering is for cash, (ii) any bona fide private financing, if such financing involves a sale of (A) common stock, for cash, at a price at least as great as each of the book and market value of the issuer's common stock; or (B) securities convertible into or exercisable for common stock, for cash, if the conversion or exercise price is at least as great as each of the book and market value of the issuer's common stock. Under Nasdaq Rule 5635(d), shareholder approval is required prior to an issuance, other than a public offering, of common stock (or securities convertible into or exercisable for common stock), equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance at a price that is less than a price that is the lower of: (i) the closing price immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement. An offering for purposes of the shareholder approval rules will not be treated as a public offering merely because it is a public offering registered with the Securities and Exchange Commission (SEC). When determining whether an offering is a public offering for purposes of these securities exchange rules, the staff will consider all relevant factors, including but not limited to: (i) the type of offering (i.e., an underwritten firm commitment offering or a best-efforts/agency offering); (ii) the manner in which the offering is marketed, including the number of investors offered securities, how those investors were identified, and the breadth of the marketing effort; (iii) the extent of the offering's distribution (including the number and identity of the investors participating in the offering and whether any prior relationship existed between the issuer and those investors); (iv) the offering price (including the extent of any discount to the market price of the securities offered); and (v) the extent to which the issuer controls the offering and its distribution.

## 8. BABY SHELF RULES AND CONCURRENT PRIVATE PLACEMENT

An issuer with a public float of less than $75 million may use a registration statement on Form S-3 for a primary offering in reliance on Instruction I.B.6 (Baby Shelf Rule), which permits an issuer to sell no more than one-third of its public float within a 12-month period and requires the issuer's securities

to be listed on a securities exchange (excluding the OTCBB). In addition, the SEC Staff has stated in its Compliance and Disclosure Interpretation Question 116.25 that if an issuer sells securities to investors consisting of registered securities pursuant to a registration statement on Form S-3 under the Baby Shelf Rule and securities in a concurrent private placement that will be registered for resale on a separate Form S-3 in reliance on Instruction I.B.3, such resale securities would be counted toward the Baby Shelf Rule limitation at the time of the resale registration statement filing. If the issuer exceeds the Baby Shelf Rule limitation, it would need to either register the resale on Form S-1 or wait until it has sufficient capacity under the Baby Shelf Rule to register the resale on Form S-3. If an issuer is relying on the Baby Shelf Rule, they must make sure the RDO and any other transaction conducted in the 12-month period does not exceed one-third of its public float.

## 9. DEPOSITORY TRUST CORPORATION (DTC) AND SETTLEMENT

Shares in an RDO are sold through the DTC's book-entry system as electronic book entries and not as physical stock certificates. Investors will receive a confirmation or statement containing the number of securities allocated to their account and closing and account wiring instructions. In some cases, all RDO shares are settled by delivery to the placement agent's DTC account for further delivery to investor accounts by the placement agent. In other cases, the shares are allocated directly to investors' accounts with DTC or the accounts of the DTC participants or indirect participants identified by the investors for settlement. Counsel should understand the closing and settlement mechanics and ensure that all parties are made aware of the settlement instructions.

## 10. APPLICATION OF REGULATION M AND STATUTORY UNDERWRITER ROLE

Under Regulation M, an RDO is a distribution and Regulation M trading restrictions are applicable to the transaction. As a result, the placement agent should consider the applicable restricted period and the requirement to deliver the Regulation M notice to FINRA. In addition, an RDO placement agent 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. The placement agent and its counsel will want to take this into account in connection with due diligence, as well as with drafting and negotiation of the placement agency agreement.