



### Here's the deal:

- A rights offering provides a company's stockholders an opportunity to subscribe for additional shares, based on the number of shares they own as of a set record date.
- Rights offerings typically remain open for a set period, which is usually a couple weeks.
- A rights offering does not require stockholder approval, provided that the rights offering is not a "standby" rights offering, wherein the standby purchaser receives special rights or preferences.
- A majority of rights offerings involve non-transferable rights, although an issuer can also elect to structure an offering to permit rights to be transferable.
- Trading of the transferable rights can take place either on the securities exchange where the issuer's common stock is listed or over the counter, if the common stock is not listed on a securities exchange.

### Introduction

In the midst of the economic downturn driven by the COVID-19 pandemic, companies facing liquidity issues may consider a rights offering. This guide provides an overview of rights offerings.

### What's the Deal?

A rights offering typically provides an issuer's existing shareholders the opportunity to purchase a *pro rata* portion of additional shares (also referred to as "subscription warrants") of the issuer's stock at a specific price per share (the "subscription price"), which may be set at a discount to the recent trading price of the issuer's stock.

In a rights offering, all shareholders are given the right to purchase shares based on the number of shares they own on a specified record date, so there is no dilutive effect to shareholders who exercise the rights issued to them. Because there is no dilutive effect, stock exchange rules generally do not require issuers to obtain shareholder approval for issuances that may involve 20% or more of the outstanding shares at a discount to current market value.

Typically, a rights offering will be open for a period of a couple weeks. There are no federal securities laws requiring the rights offering to be open for a specified period of time.

## Types of Rights Offerings

### STANDBY RIGHTS OFFERING

In a standby rights offering, a third party (usually an underwriting syndicate, an investment bank, an affiliate of the investment bank or an affiliate of the issuer that may not be a registered broker-dealer) agrees, prior to the commencement of the rights offering, to purchase any shares or rights that are not subscribed for in the rights offering. This arrangement is commonly known as a “standby commitment,” and provides the issuer with some assurance that it will raise the necessary capital. If the rights offering is structured as a standby rights offering, the issuer will enter into an agreement with the party agreeing to provide the standby commitment. An issuer may also consider a standby rights offering if the issuer’s stock price is volatile. This is because the offering period is usually at least 16 days but can extend up to 60 days. Most shareholders will wait until the end of the subscription period to decide whether to exercise their rights. If the shares are trading in the market for the same or less than the subscription price, then shareholders will not exercise their rights. The issuer has to consider where to set its subscription price to avoid this, while not selling the shares at too steep of a discount price. Entering into a standby commitment may help mitigate this issue.

- *Fees associated with a standby commitment:* As compensation for shifting the risk from the issuer if there is an under-subscription, the standby commitment party is paid a flat standby fee, plus a per share amount for each unsubscribed share purchased by it after the subscription offer expires and for each share purchased by it on the exercise of rights purchased in the secondary market, if the rights are transferable.
- *Requirements for standby commitment parties:* There is no broker-dealer licensing requirement for standby commitment parties, although most are investment banks or an underwriting syndicate formed by an investment bank. However, one or more substantial investors will sometimes agree to act as a standby commitment party.

### DIRECT RIGHTS OFFERING

In a direct rights offering, there is no standby commitment party, or standby purchaser. Instead, the issuer only sells the number of shares evidenced by the exercised rights. A direct rights offering is cheaper than a standby rights offering because there are no fees associated with providing the standby commitment. However, a poorly subscribed direct rights offering may leave an issuer under-capitalized.

## Preparation and Considerations in Connection with a Rights Offering

A rights offering requires advance planning and preparation. The issuer must take a number of actions within a certain time frame, including, but not limited to, the following: providing information to shareholders; marketing the rights offering to shareholders; collecting exercise certificates and payment from shareholders; and filing documentation with the SEC and the applicable stock exchange.

More specifically, the issuer must determine if it has sufficient authorized and unissued shares to accommodate the number of shares that could be issued in connection with the rights offering. If not, the necessary corporate actions must be taken to authorize new shares. The issuer’s board of directors will be required to: (1) authorize the rights offering; (2) set the record date to determine the shareholders of

record entitled to participate in the rights offering; (3) set an offer date; and (4) set an expiration date for the offer period.

If other events or activities, which require a record date, are approaching, such as a record date for an annual shareholders meeting, or dividend distribution, the issuer must also ensure that there are no conflicting shareholders of record for two different events or activities occurring around the same time period. Once the record date is set for the rights offering, no other record date for any other purpose should be set by the issuer for at least 7 business days after the expiration of the offering period.

### Additional Considerations for a Standby Rights Offering

If an issuer chooses to conduct a standby rights offering, it will have to consider who will act as the standby commitment party, often referred to as the “standby purchaser,” and the amount of the commitment, which will be based on the issuer’s financing needs. Additionally, in a standby rights offering, the issuer may want to put a cap on the number of shares that the standby commitment party may acquire in order to avoid an inadvertent change of control. Furthermore, in a standby offering that involves transferable rights, a market may develop for the rights that may create arbitrage opportunities (between the issuer’s common stock and the rights) or price volatility in the issuer’s common stock.

### Participants in Rights Offerings

Unless the issuer is a large corporation or has a highly concentrated shareholder base, it will most likely seek assistance from third-party participants. Depending on the size of the issuer and the type of rights offering, the issuer may engage a dealer-manager, a subscription agent, and/or an information agent. The issuer also may engage an investment bank (underwriter) to act as the standby purchaser. The role of each party is presented in some detail below:

*The role of the deal-manager.* Usually a dealer-manager is hired to market the rights offering and solicit the exercise of rights and participation in the over-subscription privilege, if any. In a non-transferable rights offering, issuers may opt to avoid marketing expenses and sales commissions by doing this themselves.

*The role of the subscription agent.* Usually, a subscription agent is hired to send a prospectus or prospectus supplement, as the case may be, and to collect all of the completed subscription certificates and related payments from the shareholders. This role may be filled by an issuer’s transfer agent.

*The role of an information agent.* Usually, an information agent is hired to answer any shareholder questions and provide further information about the rights offering. If the issuer has an adequately staffed investor relations department, a third party may not be required for this task.

### Rights Offerings for Business Development Companies

Business development companies (“BDCs”) are closed-end funds that are regulated by the Investment Company Act of 1940, as amended (the “1940 Act”). Under regulatory constraints imposed by the 1940 Act, BDCs cannot issue shares of its common stock and sell them at a price below its net asset value (“NAV”) without first obtaining shareholder approval. However, if a BDC hopes to sell shares below the NAV, without shareholder approval, the BDC may do so through a rights offerings to its existing shareholders.

A BDC will typically complete a rights offering in two phases: the primary subscription period and the oversubscription period. In the first phase, shareholders are given the exclusive opportunity to purchase additional shares from the BDC, on a pro-rata basis. In the second phase, shareholders that have fully participated in the primary subscription period will be permitted to purchase additional shares as part of the oversubscription period. Rights offerings for BDCs can be transferable or non-transferable. In the case that a BDC rights offering is transferable, shareholders will be allowed to sell those rights in the open market. The SEC's position, has generally been, that for every three shares of common stock currently outstanding, no more than one additional share of common stock can be issued in a transferable rights offering, below the NAV. In non-transferable rights offerings, however, BDCs will not be subject to these restrictions, since the anti-dilution concern is diminished.

## Regulatory Requirements for Rights Offerings

Because the rights are granted to existing shareholders for no consideration, the rights do not need to be registered with the SEC; however, the issuer must register the shares that will be allocated to the shareholders who elect to participate in the rights offering. In certain circumstances, rights may need to be registered. In a transferable rights offering, if a controlling shareholder chooses to trade rights rather than exercise them, the requisite number of rights would need to be registered and a statement would need to be included in the prospectus stating that the prospectus may be used to cover the sales of rights by such controlling shareholder. The issuer must file a registration statement on Form S-1 or Form S-3, if eligible or, if an issuer has an effective existing shelf registration statement, the issuer can review it to determine if it covers the offer of rights.

Regulation M covers market manipulation during rights offerings. Therefore, if a rights offering involves a distribution as defined in Rule 100, the applicable restricted period of Rules 101 and 102 applies to bids for or purchases of the security being distributed and any reference security. Transactions involving the rights themselves are not subject to Rule 101 or 102. However, Rule 104 applies to stabilization transactions in any security, including the rights.

## Stock Exchange Requirements for Rights Offerings

The New York Stock Exchange ("NYSE") and Nasdaq Stock Market ("Nasdaq") have similar requirements for rights offerings, although summarized briefly below, these requirements require a closer look:

- NYSE Rule 703.03(B); Nasdaq Rules 5250(b)(l). The NYSE requires all known terms and details of a proposed rights offering to be publicly released immediately after the issuer's board of directors has taken action. Nasdaq requires the issuer to promptly disclose any material information that would reasonably be expected to affect the value of its securities.
- NYSE Rule 703.03(B); Nasdaq Rules 5250 (e)(6). The exchanges require at least ten days' advance notice of any record date fixed in connection with an offering of listed securities to shareholders.
- NYSE Rule 703.03(C). The NYSE requires issuers to send written notice to shareholders at least ten days in advance of the proposed record date. The notice should state that the issuer intends to make a rights offering. The notice should also include to the extent finally determined: (1) the title of the security to be offered; (2) the proposed subscription ratio; (3) the proposed subscription price; (4) the proposed record date for determination of those entitled to subscribe; (5) the

proposed expiration date of the right to subscribe; and (6) the expected date on which the subscription certificates will be mailed.

- NYSE Rule 703.03(E). The NYSE requires that shareholders of listed securities be allowed at least 16 days after the rights have been mailed to subscribe to the offering, although it could be reduced to fourteen days if certain mailing conditions are met. Further, it is recommended that subscription certificates be issued to stockholders as soon as practicable after the record date.
- NYSE Rule 703.03(M). The NYSE requires that the issuer notify it by telephone immediately upon receiving notice that the registration of the offered securities has become effective.
- NYSE Rule 703.03(N). It is highly recommended that the issuer list rights, if they are transferable, in addition to listing the new shares on the exchange.
- NYSE Rule 703.03(A). It is recommended that the issuer confer with its exchange representative well in advance of the offering date to ensure coordination of actions and arrangement of a time schedule.
- NYSE Rule 703.03(D). It is recommended that (1) the effective date be set for at least 6 business days in advance of the record date in order to prevent confusion if there is a delay in the effectiveness of the registration statement, unless the issuer already has an effective shelf registration statement and (2) the issuer's board of directors establish the record date as a specified date "or such later date as registration under the Securities Act of 1933 shall become effective." It is required that once the record date is set for the rights offering, no other record date for any other purpose should be set by the issuer between the record date for the subscription offering through at least 7 business days after the expiration of the offering period.

## Comparing a Rights Offering with a PIPE Transaction

With public companies, a rights offering is a form of public offering that may have comparable characteristics to private investment in public equity ("PIPE") transactions. Rights offerings offer a number of advantages compared to PIPE transactions. For example, rights offerings typically have no shareholder approval requirements. Therefore, rights offerings can be completed more quickly than other forms of financing and can be a cheaper source of pre-filing and post-filing capital raising for issuers contemplating, or emerging from, chapter 11 bankruptcies.

Additional comparisons between rights offerings and PIPE transactions are offered below.

Differences	Rights Offerings	PIPE Transaction
Stockholder approval	No. Even if the rights offering results in an issuance of common stock representing 20% or more of the voting power outstanding before the issuance unless there is a standby purchaser.	Yes. If more than 20% of the pre-transaction total outstanding shares are being issued at a discount or if the transaction represents a change of control.
Usual marketing materials	Less marketing required, since the offering is made to existing shareholders. The issuer must file a prospectus or prospectus supplement, as the case may be, with the SEC.	Investors will typically rely on the issuer's public filings.

Differences	Rights Offerings	PIPE Transaction
Purchase agreement between the issuer and each investor	Not required. There will be a standby agreement in transactions involving a standby purchaser.	Yes. Purchase agreements are entered into by investors, committing them to purchase a fixed number of shares at a fixed price.
When offered, securities may be transferred	A majority involve non-transferable rights.	Securities are restricted, may be resold in other exempt transactions or pursuant to an effective resale registration statement.

### *Checklist of Key Questions*

- Has the issuer made a decision as to whether it will use a direct rights offering or a standby rights offering?
- Does the issuer have enough authorized and unissued shares to accommodate the number of shares that will be issued in connection with the rights offering?
- Will the rights be transferable?
- Will there be a standby purchaser, and who will act as a standby purchaser?
- How will the standby purchaser be compensated?
- If there is a standby purchaser, will the securities exchange rules require shareholder approval to be obtained?
- Will the issuer retain a dealer-manager or other third parties?
- Is the rights offering being undertaken in the context of a distressed issuer that may need to provide additional disclosures?