

Top 10 Practice Tips: Negotiating an Underwriting Agreement

A Practical Guidance® Practice Note by
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In connection with a registered securities offering, the underwriters of the offering typically enter into an underwriting agreement with the issuer of the securities and any selling stockholders. The underwriting agreement sets forth the terms and conditions pursuant to which the underwriters will purchase the offered securities and distribute them to the public. Both the issuer's and underwriters' legal counsel play critical roles in negotiating key provisions of the underwriting agreement that have significant effects on the offering. Below are 10 practice tips to consider in drafting and negotiating an underwriting agreement.

1. Form of underwriting agreement. The lead underwriter's counsel is expected to provide the initial draft of the underwriting agreement. A good starting point would be the form of underwriting agreement of the lead underwriter, which will contain the representations, warranties, and covenants

generally sought by the underwriter. The form can then be tailored to address the specific facts and circumstances, and can be negotiated with the issuer's counsel, which may request carve-outs, materiality or knowledge qualifiers, changes to the language of specific representations or warranties, or changes to key definitions, many of which we discuss below. In adapting a lead underwriter's form underwriting agreement, consider whether the offering relates to securities of a domestic or a foreign issuer, whether the offering will involve selling stockholders, and whether the offering is the issuer's initial public offering or a follow-on offering. In the latter case, for a follow-on offering, it is often instructive to review the underwriting agreements the issuer entered into for their prior securities offerings. The issuer's counsel ought to review current precedent by taking a look at underwriting agreements entered into in other recent offerings by companies in the same industry as well as in offerings by other companies led by the same underwriter in order to gauge the willingness of the lead underwriter and its counsel to accede to requests for changes to the underwriting agreement. Most underwriters have revised their form agreements in order to address the recognition by the issuer of the application of the U.S. special resolution regime for underwriters that are covered entities under U.S. banking laws. As well, to the extent that transactions include selling stockholders that are individuals, forms have been revised to address the application of Regulation Best Interest. Finally, given that all issuers can use test the waters communications, underwriting agreements also may require updating in this regard.

2. Tailored representations and warranties. During the drafting process, both the underwriters' and issuer's counsel should focus on tailoring the representations and warranties to current market precedent based on recent offerings in the issuer's industry and for an issuer of similar sophistication (in terms of the issuer's status as a large accelerated filer or well-known seasoned issuer, among other things). The representations and warranties provide both parties an opportunity to focus on and resolve any open diligence issues, and industry-tailoring can help both parties identify the protections or issues that are most important to them given the issuer's line of business, regulatory considerations, and market precedents. Both parties also should consider the type of offering, which may range from a new issuer's initial public offering of common stock to a seasoned issuer's follow-on offering of debt, equity, or equity-linked securities, when tailoring representations and warranties in order to ensure that they address issues that relate to the particular offering. Parties should also consider the impact that the pandemic caused by the novel coronavirus (COVID-19) outbreak has had on the issuer, its business and prospects and appropriately tailor the representations and warranties as a result.

3. Definition of material adverse change. An underwriting agreement should define an event that triggers a material adverse change (MAC) or material adverse effect (MAE). Depending on how these terms are defined, a breach in a representation or warranty may result in a MAC or MAE in the issuer's business and results of operations and therefore allow the underwriters the opportunity to exit the transaction, because the occurrence of the MAC or MAE resulted in it being impracticable or inadvisable to pursue the offering (commonly referred to as a market-out). The underwriter will want to draft the MAC or MAE provision as broadly as possible in order to allow the most flexibility to exit the deal if a representation or warranty is breached. Form underwriting agreements may also include forward-looking language that defines a MAC or MAE as a material change in the issuer's prospects, granting the underwriters additional flexibility if a breach occurs that may not be material at present but could potentially have material adverse effects in the future. The issuer may insist on narrowing the definitions of MAC and MAE so as to not give the underwriters the freedom to walk away from the transaction and they may seek to minimize or

remove any language that provides the underwriters full discretion to determine on their own whether or not a particular event has risen to the level of a MAC or MAE. The issuer also may seek to strike any forward-looking language to prevent the underwriters from exiting a transaction upon the occurrence of a nonmaterial breach.

4. Knowledge qualifiers. When drafting an underwriting agreement, underwriters will require the issuer to make representations about the state of its business and the marketability of its securities. In respect of certain issuer representations and warranties that relate to assets or disputes as to which diligence may be costly or where there may be some difficulty associated with accessing information related to third parties, there is often negotiation as to whether these representations will be given without qualification or whether a particular representation should be given subject to a knowledge qualifier. An issuer will want to limit any representations about itself and its business to what it knows or reasonably should know in order to avoid an unanticipated breach. The underwriter, however, will seek to limit the knowledge qualifiers included in the underwriting agreement as much as possible, because the issuer is in the best position to provide accurate information about its business. If a knowledge qualifier is included, legal counsel for the underwriters should consider adding a due inquiry provision to provide support.

5. FCPA, OFAC, and anti-money laundering representations. In the underwriting agreement, the issuer is expected to make representations relating to its compliance with the Foreign Corrupt Practices Act of 1977 (FCPA), the sanctions administered by the Office of Foreign Assets Control (OFAC) of the U.S. Department of the Treasury, and anti-money laundering (AML) laws. Underwriters have placed increased importance on these compliance representations because of recent increased enforcement activity by federal authorities and severe civil and criminal penalties that result from violations of these laws. The underwriters therefore should focus on maintaining the standard FCPA, OFAC, and AML representations in the form underwriting agreement designated by the lead investment bank. Nonetheless, the issuer may want to tailor these representations and warranties to its specific circumstances. A common negotiation point is the scope of the parties subject to the representation. Most form underwriting agreements certify compliance by the

issuer, its subsidiaries and their respective directors, officers, employees, and agents. The issuer may be able to agree on a narrower selection of parties, identifying those parties that the issuer has more direct control over, or oversight of, as it may be costly or impractical to locate every one of its agents. Additionally, the issuer may be able to add a knowledge qualifier to a representation or warranty that certifies compliance of one or more parties over which it does not have direct control.

- 6. Underwriter information carve-out.** When drafting the underwriting agreement, the underwriters will typically provide a short list of information that they are providing to the issuer to be included in the prospectus. This information is typically limited to the underwriters' name, contact details and intended distribution as well as stabilization methods. The underwriters often agree to indemnify the issuer for any claims arising from the use of some or all of the information on the list. The underwriters will want to specifically identify a very limited list of the information they provide the issuer, either prepared by the underwriters, their counsel or third parties selected by them, in order to define clearly the scope of the indemnity. Because this information will be used for the prospectus and any road show presentations, the issuer will want to draft the information carve-out as broadly as possible in order to protect itself from claims caused by misinformation or misstatements made by the underwriter.
- 7. Indemnification and termination.** Underwriters' counsel typically insists on few to no changes being made to the indemnification and termination sections from the language included in the representative underwriter's form underwriting agreement. Underwriters want as much flexibility as possible in order to exit the transaction in the event of a termination and as much protection as possible in the event of litigation. Beyond negotiating the definitions of MAE or MAC as described above, which would by consequence limit the scope of the termination provision in the underwriting agreement and what situations indemnification would trigger, the issuer and its counsel are unlikely to convince the underwriters to make any substantive changes to these sections and thereby create a narrower public market precedent. Notwithstanding the issuer's inability to materially amend the form indemnity section, the issuer and their counsel should insist that the indemnity provided by the underwriters to the issuer, as described above, uses the same protective language as the indemnity provided by the issuer to the underwriters.

8. Lockups. During and following the transaction, the underwriters will want to prevent the issuer from issuing, and its directors and senior executives from selling any securities that could negatively affect the pricing of the securities in the offering. A large issuance of the issuer's shares could dramatically decrease the demand, and thus the price, of the securities offered in the transaction or cause investors to become more skeptical about the potential risk of investing in the securities to be offered by the underwriter. In an initial public offering, the underwriters will seek to obtain lock-up agreements from all or substantially all existing security holders for a period of 180 days. The issuer should seek carve-outs that will prevent the lockup from interfering with existing contractual commitments. These include, but are not limited to, carve-outs for already planned issuances or transfers of securities, ordinary course lending or capital markets activities, and issuances for employees under existing agreements or to attract or retain key talent. For more practice tips on lock-up agreements, see [Top 10 Practice Tips: Lock-Up Agreements](#).

9. Offering expenses. The issuer is expected to pay for or reimburse the underwriters for any offering-related expenses. The issuer is also expected to reimburse the underwriters for counsel expenses relating to the Financial Industry Regulatory Authority (FINRA) review. The issuer typically includes a limitation on the amount reimbursable for underwriter counsel fees in connection with the FINRA review. On September 16, 2020, FINRA implemented amendments that significantly streamlined the filing and approval process for shelf offerings that are subject to a filing requirement; as a result, the amount reimbursable for underwriter counsel fees in a shelf offering should be minimal. The underwriting agreement may also include a provision requiring the underwriters to reimburse the issuer for certain offering expenses in the event that the underwriters breach the underwriting agreement. For example, an issuer may request reimbursement if the underwriters fail to market the securities in a manner consistent with the underwriting agreement. Notwithstanding the limited reimbursement obligation, the underwriters are expected to pay for their own counsel.

10. Deliverables. The underwriting agreement will specify the documents that are required to be delivered to the underwriters as a condition to completing the offering. Deliverables include legal opinions to be delivered by each party's counsel, officers' and secretary's certificates, good standing certificates, and a comfort letter from the

issuer's independent auditor. Both counsels should also deliver negative assurance letters to the underwriters that confirm that no material misstatements or omissions were included in the prospectus. This letter allows either party to establish a due diligence defense against claims that missing or misstated material information has misled investors. The comfort letter delivered by the issuer's auditor provides certain assurances regarding the independence of the auditors, their completion of an audit for the annual financial statements, their completion of a review for interim financial statements, the conformity of the issuer's financial statements to U.S. GAAP or IFRS as adopted

by the IFRS, as well as certain agreed-upon procedures in relation to other financial information contained in the offering documents and derived from the financial statements. Depending on the nature of the issuer's business and the laws and regulations applicable to their business, underwriters' counsel should also seek additional specialist opinions from counsel to the issuer, such as tax matters, regulatory matters, or intellectual property matters. Due to the short period between signing and closing (typically two business days), the underwriters' and issuer's counsel should negotiate the scope of all legal opinions as far in advance as possible.

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Anna Pinedo is a partner in Mayer Brown's New York office and co-leader of the Global Capital Markets practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer and specialty finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

Anna regularly speaks at conferences and participates in panel discussions addressing securities law issues, as well as the securities issues arising in connection with derivatives and other financial products. She is the co-author of the leading capital markets treatise, *Corporate Finance and the Securities Laws*, published by Wolters Kluwer (6th Ed., updated 2020); co-author of *A Deep Dive Into Capital Raising Transactions*, published by the International Financial Law Review (2020); co-author of *JOBS Act Quick Start* (International Financial Law Review, 2013; updated 2014, 2016); contributor to *OTC Derivatives Regulation Under Dodd-Frank: A Guide to Registration, Reporting, Business Conduct, and Clearing* (Thomson Reuters, first ed. 2014, second ed. 2015, third ed. 2016, fourth ed. 2017); co-author of *Considerations for Foreign Banks Financing in the US* (International Financial Law Review, 2012; updated 2014, 2016); co-author of *Liability Management: An Overview* (International Financial Law Review, 2011, updated 2015); co-author of *Structuring Liability Management Transactions* (International Financial Law Review, 2018); co-author of *Covered Bonds Handbook*, published by Practising Law Institute (2010, updated 2012-2014); co-author of the treatise *Exempt and Hybrid Securities Offerings*, published by Practising Law Institute (2009, second ed. 2011, updated 2014, third ed. 2017); and co-author of *BNA Tax and Accounting Portfolio: SEC Reporting Issues for Foreign Private Issuers* (BNA Accounting Policy and Practice Series, 2009, second ed. 2012, third ed. 2016, fourth ed. 2020). Anna is also a contributing author to *Broker-Dealer Regulation* (2011, second ed. 2012, updated 2020), published by Practising Law Institute. She co-authored "The Approaches to Bank Resolution," a chapter in *Bank Resolution: The European Regime* (Oxford University Press, 2016). Anna contributed to *The Future of Bank Funding and Capital: Solutions for Issuers, Opportunities for Investors* (IFR Market Intelligence, 2009). Additionally, Anna co-authored "The Ties that Bind: The Prime-Brokerage Regulation," a chapter in *Global Financial Crisis* (Globe Law and Business, 2009); "The Law: Legal and Regulatory Framework," a chapter in *PIPEs: A Guide to Private Investments in Public Equity* (Bloomberg, 2006); and "The Impact Security: Reimagining the Nonprofit Capital Market," a chapter in *What Matters: Investing in Results to Build Strong, Vibrant Communities* (Federal Reserve Bank of San Francisco and Nonprofit Finance Fund, 2017). Anna is a contributor to Practising Law Institute's "BD/IA: Regulation in Focus" blog.

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Brian is a thought leader and frequently authors articles relating to capital markets trends and topics published by *Thomson Reuters' Practical Law Company*, *the Practising Law Institute*, *Bloomberg* and *LexisNexis*. The IFLR1000 2022 guide ranks Brian as a "Rising Star Partner" in the United States for Capital Markets: Equity, and he is also a recommended lawyer by *The Legal 500 US*.

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