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FREQUENTLY ASKED QUESTIONS ABOUT AT-THE-MARKET OFFERINGS

Understanding At-the-Market Offerings

What is an "at-the-market" offering?

An "at-the-market" offering is an offering of securities into an existing trading market for outstanding shares of the same class at other than a fixed price on, or through the facilities of, a national securities exchange, or to or through a market maker otherwise than on an exchange. Therefore, the price at which securities are sold in an at-the-market offering will vary because it is based on the price of the securities in the trading market.

What is an "equity distribution program"?

An "equity distribution program" provides a means for an issuer to conduct at-the-market offerings from time to time using a shelf registration statement to or through a broker-dealer acting either on a principal or agency basis. Each at-the-market offering then is a "takedown" from the related shelf registration statement. Note that an issuer can use an equity distribution program for the sale of new securities (*i.e.*, "primary shares") and/or securities held by existing security holders (*i.e.*, "secondary shares").

One may also think of an equity distribution program as the equity analogue to a medium-term note program, which allows an issuer to take down debt, rather than equity securities, from time to time. Equity distribution programs often are referred to as "equity shelf programs" or "equity dribble out programs." Several investment banks also have created trademarked product names for these programs.

Note that one should not confuse equity distribution programs with equity lines of credit, which are fundamentally different because, among other things, they rely on fixed prices that are agreed upon prior to commencement. For more information regarding equity lines of credit, *see "What is the difference between an 'equity line of credit' and an equity distribution program?"*

What are the advantages of at-the-market offerings?

At-the-market offerings provide issuers with several advantages over traditional follow-on offerings, including the following:

- *Minimal market impact*. Issuers can quickly raise capital by selling newly issued shares into the natural trading flow of the market, without having to market and/or announce the offering. As a result, shares are able to "trickle" into the market, without impacting the issuer's stock price. Investors cannot short the issuer's stock in advance of the offering since the timing of any particular takedown is not known.
- *Flexibility*. Sales can be effected on an agency or principal basis, and the terms of each sale, including its timing and size, are agreed upon between the issuer and the agent, at the issuer's discretion. This enables an issuer to match its capital structure to its ongoing needs. For example, an issuer can implement a limit price below which sales will not occur and/or a percentage limitation on daily sales to reduce downward price pressure on its stock, as well as dilution.
- *Low cost*. The distribution costs for at-the-market offerings (usually 1-3%) typically are less than for traditional follow-on offerings, and the absence of an issuer commitment to sell means that there will be no sales below acceptable share prices.
- *Minimal management involvement.* At-the-market offerings require no "road shows" and involve only limited prospectus preparation and delivery requirements.

What are the disadvantages of at-the-market offerings?

At-the-market offerings tend to be substantially smaller than traditional follow-on offerings, and thus are not as useful to issuers seeking to raise a large amount of capital. The price of an at-the-market offering also depends on market pricing and is not fixed, thus the cost of raising capital may fluctuate as the market fluctuates, unlike an equity line of credit or a credit facility. At-the-market offerings also are still registered offerings, and despite enabling issuers to trickle shares into the market, are not as stealthy as private placements, including PIPE transactions, which are announced only after pricing and for which resale registration statements are filed only after closing, or confidentially marketed public offerings.

What types of issuers conduct at-the-market offerings?

At-the-market offerings recently have become more common, as issuers seek alternative sources of funding. At-the-market offerings are particularly useful for issuers that:

- frequently need to raise additional capital, including REITS, mortgage REITs, biotech companies, and energy and utility companies;
- wish to engage in regular balance sheet maintenance;
- seek to raise small amounts of organic growth capital;
- seek to finance a small acquisition or series of small acquisitions; and
- have insiders that wish to sell registered securities.

Shelf Eligibility / Limitations on Shelf Registration for At-the-Market Offerings

What are the eligibility requirements for filing a shelf registration statement for an at-the-market offering?

An issuer must be eligible to use a shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers) on a primary basis (*i.e.*, "primary eligible") in order to register securities for sale in at-the-market offerings.

In order to be eligible to use Form S-3 (or Form F-3 for foreign private issuers), the issuer, among other things:

- must have a class of securities registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act") (or must be required to file reports under Section 15(d) of the Exchange Act);
- must have been subject to the reporting requirements of Sections 12 or 15(d) of the Exchange Act for at least 12 calendar months immediately preceding the filing of the registration statement and have timely filed all required reports with the Securities and Exchange Commission (the "SEC") during that period; and
- since the end of the last year covered by its audited financial statements, cannot have failed to pay dividends or sinking fund installments on preferred stock, or defaulted on installments on indebtedness for borrowed money or on material leases.

What does it mean to be "primary eligible"?

An issuer is "primarily eligible" to use Form S-3 to offer securities on its own behalf for cash on an unlimited basis in at-the-market offerings, if (1) the aggregate market value of its voting and non-voting common equity held by non-affiliates (*i.e.*, public float) is at least $75 million, or (2) one of the following four tests are satisfied:

- the issuer has issued (as of a date within 60 days prior to the filing of the shelf registration statement) at least $1 billion in non-convertible securities other than common equity, in primary offerings for cash, not exchange, registered under the Securities Act of 1933, as amended (the "Securities Act"), over the prior three years;
- the issuer has outstanding (as of a date within 60 days prior to the filing of the shelf registration statement) at least $750 million of non-convertible securities other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act;
- the issuer is a wholly-owned subsidiary of a WKSI; or
- the issuer is a majority-owned operating partnership of a real estate investment trust that qualifies as a WKSI.

An issuer with a public float of less than $75 million may register primary offerings of its securities on Form S-3 (or Form F-3 for foreign private issuers) if it:

- meets the other eligibility requirements of Form S-3 (or Form F-3 for foreign private issuers);
- is not and has not been a "shell company" for at least 12 calendar months prior to the filing of the Form S-3 (or Form F-3 for foreign private issuers);
- has a class of common equity securities listed on a national securities exchange (*i.e.*, not the over-the-counter market or the "pink sheets"); and

- does not sell in a 12-month period more than the equivalent of one-third of its public float.

In addition, former shell companies must also have timely filed their periodic reports for at least 12 calendar months and filed all of the detailed information that would be required under the Exchange Act in a registration statement on Form 10 (or Form 20-F for foreign private issuers).

For more information regarding shelf registration, *see* our "Frequently Asked Questions About Shelf Registration Offerings" available at: http://media.mofo.com/files/Uploads/Images/FAQs-Regulation-S.pdf.

Are there any limitations on registration for at-the-market offerings?

As part of the rules relating to the securities offering process that became effective on December 1, 2005 ("Securities Offering Reform"), the SEC eliminated certain restrictions that previously governed at-the-market offerings of securities registered on shelf registration statements. Prior to the SEC's amendments, an issuer had to name the underwriters or agents involved in an at-the-market offering, and if there were no underwriters or agents specified in the initial shelf registration statement, a post-effective amendment had to be filed at the time of the at-the-market offering. In addition, the number of securities registered for at-the-market offerings could not exceed 10% of the aggregate market value of the issuer's outstanding voting stock held by non-affiliates.

As a result of Securities Offering Reform, an issuer registering an at-the-market offering of equity securities on a shelf registration statement pursuant to Rule 415(a)(4) of the Securities Act does not need to identify underwriters or agents in the shelf registration statement. In addition, there is no limit on the number of the securities that can be registered on the shelf registration statement for an at-the-market offering.

What are the benefits of qualifying as a "well-known seasoned issuer," or "WKSI," in the context of at-the-market offerings?

An issuer that qualifies as a WKSI benefits from a more flexible registration process. If a WKSI checks the applicable box on the cover of the shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers) for a primary offering, a secondary offering, or a combination of a primary and a secondary offering, the shelf registration statement will automatically be effective upon filing. In other words, there will be no delay in effectiveness as the issuer will not have to receive and respond to any SEC comments. Automatic effectiveness is particularly important because issuers considering at-the-market offerings are often interested in quickly accessing the trading market.

The additional benefits for a WKSI include the following:

- the ability to register unspecified amounts of different types of securities;
- the ability to add additional classes of securities and additional eligible majority-owned subsidiaries as additional registrants after effectiveness by filing a post-effective amendment that also will be automatically effective upon filing;
- the ability to exclude additional information from the base prospectus (included in the shelf registration statement), such as:
  - whether the offering is a primary or secondary offering;
  - a description of the securities, other than the name or class of securities (*i.e.*, "debt," "common stock," and "preferred stock"); and
  - disclosure regarding the plan of distribution;
    - paying filing fees on a "pay-as-you-go" basis at the time of each takedown; and
    - using "free writing prospectuses" relating to an offering before the shelf registration statement is filed.

What is a WKSI?

A "WKSI" is an issuer that (1) is required to file reports with the SEC under Sections 13(a) or Section 15(d) of the Exchange Act and (2) satisfies the following requirements:

- it must meet the registrant requirements of Form S-3 (or Form F-3 for foreign private issuers); in other words, it must be a "primarily eligible" issuer;
- it must, as of a date within 60 days of the filing of its shelf registration statement, either:
  - have a worldwide market value of its outstanding voting and non-voting common stock held by non-affiliates of $700 million or more; or
  - have issued in the last three years at least $1 billion aggregate principal amount of non-convertible securities in primary offerings for cash; and
- it must not be an "ineligible issuer."

A majority-owned subsidiary of a WKSI will itself be a WKSI in connection with:

- its issuance of non-convertible investment grade securities that are fully and unconditionally guaranteed by its parent; or
- its issuance of guarantees of non-convertible securities of its parent or of another majority-owned subsidiary with non-convertible securities that are guaranteed by the parent.

If the majority-owned subsidiary is itself a WKSI by reason of its issuance of $1 billion or more of non-convertible securities and also meets the test of a primarily eligible issuer (*i.e.*, the market value of common equity held by non-affiliates is at least $75 million), the subsidiary may register an offering of its common stock or other equity securities as a WKSI by filing an automatic shelf registration statement.

Filing Requirements/Documentations for At-the-Market Offerings

What needs to be filed with the SEC?

An issuer must have a shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers) on file with the SEC. The issuer can either (1) use an allocated portion of an already existing universal shelf registration statement specifically for at-the-market offerings, or (2) prepare a new shelf registration statement specifically for at-the-market offerings. If the issuer decides to use an already existing shelf registration statement, then the issuer must prepare a prospectus supplement specifically for the equity distribution program. The plan of distribution section included in the shelf registration statement, or a related prospectus supplement, must describe the general terms for the at-the-market offerings that the issuer intends to conduct, including the method of sale and commissions/fees to be paid by the issuer, and identify the broker-dealers (*i.e.*, distribution agents) that will participate in these offerings.

Upon execution of the equity distribution agreement, the issuer will file the prospectus supplement setting forth the terms of the offering and will file the agreement and any press release announcing the at-the-market offering on Form 8-K. In addition, the issuer must report quarterly on the number of shares that have been sold under the equity distribution program and related information, including the commissions paid and net proceeds to the issuer, either by means of a prospectus supplement or in its periodic filings under Forms 10-K or 10-Q. For more information regarding the distribution agreement, *see "What legal documentation is required?"*

Note that (1) if the issuer makes any sales under the equity distribution program that it considers "material" (*e.g.*, a block trade), the issuer may file a prospectus supplement that provides the same information as the quarterly prospectus supplement discussed above, and (2) pursuant to SEC interpretive guidance, the issuer may be required to file pricing supplements or prospectus supplements for takedowns under Rule 424 of the Securities Act. The issuer should discuss with its counsel any filing requirements that may arise under Rule 424. It should also be noted that the New York Stock Exchange (the "NYSE") has given informal, unwritten advice that block trades should not be included within an at-the-market offering.

Are there any prospectus delivery requirements?

An at-the-market offering of securities is a primary offering. There is a prospectus delivery obligation as to such primary offering. The provisions of Rule 153 of the Securities Act apply only to transactions between brokers, as it covers the requirement of a broker or dealer to deliver a prospectus to a broker or dealer. Rule 153 does not affect a broker's delivery obligation to purchasers other than brokers or dealers. Brokers or dealers effecting transactions in the issuer's securities may have a prospectus delivery obligation to their clients who acquired those securities (which may be satisfied in reliance on the "access equals delivery" principles of Rule 172 of the Securities Act) and similarly may have an obligation to provide a notice pursuant to Rule 173 of the Securities Act.

What legal documentation is required?

The distribution agreement, entered into between the issuer and the distribution agent, establishes the terms and conditions upon which the distribution agent and the issuer will conduct the at-the-market offerings for the equity distribution program. The agreement typically provides for both principal and agency transactions, sets forth the distribution agent's commission, and contains representations, warranties and covenants from the issuer to the distribution agent, as well as indemnification provisions. The distribution agreement typically terminates on either a fixed date or when the program amount is reached, and contains standard market-out termination provisions.

The distribution agreement requires the delivery of legal opinions (including a 10b-5 negative assurance letter from issuer's counsel), an officer's certificate, and a comfort letter from the issuer's independent auditors to the distribution agent (prior to the commencement of at-the-market offerings under the equity distribution program). The distribution agreement also requires

the bring-down of the issuer's representations and warranties to the distribution agent at the time of each at-the-market offering, as well as periodic updates to the issuer's deliverables to the distribution agent.

What level of due diligence is required?

The equity distribution program is a registered public offering. The distribution agent and its counsel will conduct due diligence regarding the issuer prior to the commencement of the equity distribution program in addition to requiring the delivery of legal opinions and a comfort letter. The equity distribution program may also require periodic updates to the initial legal opinions and comfort letter, which will require ongoing due diligence as well. The frequency of the periodic updates (*e.g.*, monthly, quarterly, based on a specified dollar threshold, etc.) is usually an important negotiating point for the distribution agent and the issuer. Note that the distribution agent also will typically conduct ongoing due diligence, irrespective of any periodic updates, prior to each takedown (usually in the form of a bring-down due diligence call with the issuer), or if the equity distribution program has been inactive, then on a periodic basis.

Note that the distribution agent may be subject to liability under Section 11 of the Securities Act, even though it may be acting as an agent only on a best efforts basis, which means that the level of due diligence required is the same as that for an underwritten follow-on offering. For more information regarding liability under Section 11, *see* "Liability Issues for At-the-Market Offerings."

How are sales executed?

Whether acting as principal or agent, the distribution agent executes any sales of the issuer's securities through ordinary brokers' transactions through securities exchanges or electronic trading systems (including electronic communication networks (ECNs) and the NYSE's DOT system) at prices related to the volume weighted average price ("VWAP") for the issuer's securities. These transactions do not involve any special selling efforts (*i.e.*, no road show or other solicitation) or an amount of the issuer's securities that would be considered significant relative to that issuer's public float or daily trading volume. Similarly, the purchasing broker does not use any special marketing efforts. The commission or spread payable by the issuer to the distribution agent (the purchasing broker receives no special selling commission) is consistent with the commission payable to a dealer executing trades rather than the spread that would be payable to a broker-dealer acting as an underwriter in connection with a distribution. Based on these various factors, the distribution agent's execution of at-the-market offerings under an equity distribution program more closely resembles ordinary dealer activity than participation as an underwriter in a securities distribution.

Compliance-Related Issues

Restricted Lists

What are "restricted" and "watch" lists and what are they used for?

The distribution agent maintains grey or "watch" lists and black or "restricted" lists. These lists help identify securities that may be the subject of investment banking or other corporate finance activity by the firm as a compliance measure. The grey or watch list identifies securities in which the investment banking department is active in some context. Placing a security on the grey or watch list will permit the compliance department to monitor trading by the firm, as well as the publication of research, or the commencement of research coverage, relating to the security in question. Usually, the content of grey or watch lists is known only to the compliance and legal groups and is not broadly disseminated. A black or restricted list usually is broadly distributed within the firm and identifies all of those securities in which trading by the firm as principal and by its employees is prohibited or restricted for the time during which the securities remain on the list.

In connection with its participation in an equity distribution program, the distribution agent should place the issuer's securities on the firm's grey or watch list upon the commencement of the program and for the remainder of its term. This will permit the distribution agent's compliance and legal departments to monitor the firm's activities related to the issuer. In addition, if the issuer's blackout period is in effect, during which time insiders are not permitted to sell securities of the issuer while the distribution agent is in possession of material non-public information, then the distribution agent should be subject to the same policy.

What are the benefits of using restricted and watch lists?

Having the issuer on the grey list for the duration of the equity distribution program will permit the

distribution agent's compliance and legal departments to monitor whether :

- the distribution agent may undertake other engagements on the issuer's behalf;
- the distribution agent may undertake an engagement that may pose a business conflict;
- the distribution agent may commence research coverage, change its research recommendations, or release a new research report;
- the distribution agent has appropriate information wall (*i.e.,* "Chinese wall") procedures in place; and
- the distribution agent can undertake proprietary trading activity in the security in question.

In light of Securities Offering Reform, the distribution agent also may wish to monitor general communications regarding the issuer in order to avoid having an ordinary course communication potentially be viewed as a "free writing prospectus" related to that issuer.

The distribution agent also may consider including the issuer on the firm's black or restricted list, instead of on the firm's grey or watch list. However, given the long-term nature of an equity distribution program and the limited nature of the distribution agent's execution activities in connection with an equity distribution program, placing the issuer on a black or restricted list may be limiting and suggestive of more active banking involvement by the distribution agent than is actually occurring.

Research Coverage Issues

Can a distribution agent provide research coverage in connection with at-the-market offerings?

A distribution agent can participate in an equity distribution program even if it already provides research coverage regarding the issuer or plans to provide such coverage in the future. In either case, a number of questions arise concerning the distribution agent's research activities in light of the banking services that it provides the issuer, including the following:

- If the distribution agent does not provide research coverage for the issuer, when may the distribution agent commence research coverage?
- If the distribution agent already provides research coverage for the issuer, does the distribution agent need to monitor the timing of new research reports, recommendations included in such research reports, and whether any such research reports are published with "reasonable regularity"?

All of these questions assume that (1) the distribution agent's participation as an agent ensures that it is a "distribution participant" in connection with the issuance of securities by the issuer and (2) the research coverage will not be regarded as a free writing prospectus unauthorized by the issuer or the distribution agent.

The SEC has indicated that the existence of a shelf registration statement does not by itself constitute a "distribution" but that individual takedowns from the shelf registration statement will constitute "distributions." It is not clear whether the SEC would deem an issuer with an equity distribution program to be "in distribution" during the term of the program. This seems an unlikely result given that the issuer may have an equity distribution program in place for several months without accessing the program during that period.

If the distribution agent provides research coverage that is regarded as a free writing prospectus, unauthorized by the issuer or the distribution agent, and broadly disseminated, and the issuer is deemed to be "in distribution," then the research coverage would need to be filed with the SEC on the day of first use. Research coverage may be regarded as a free writing prospectus if it conditions the market for the issuer's securities or constitutes an offer or sale of the issuer's securities. In any event, the distribution agent should make sure to conduct its research activities in as impartial a manner as possible and avoid any activity that would be construed as an offer or sale of the issuer's securities.

What research coverage is permissible?

Rule 139(a) of the Securities Act permits a broker-dealer that participates in a distribution of securities of an issuer meeting the eligibility requirements of Form S-3 (or Form F-3 for foreign private issuers) to publish a "research report" regarding the issuer or any class of its securities without having the research report considered an "offer" or a non-conforming prospectus, provided that the research report is included in a publication distributed with reasonable regularity in the normal course of the broker-dealer's business. Since all equity distribution programs require a shelf registration statement on Form S-3 (or Form F-3 for foreign private issuers), Rule 139(a) applies to all research reports issued by the distribution agent.

Under Rule 139, a "research report" refers to a written communication that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably

sufficient upon which to base an investment decision. In order to comply with the Rule 139(a) safe harbor, for the duration of the equity distribution program, the distribution agent must ensure that:

- the research report is contained in a publication that:
  - is distributed with reasonable regularity in the normal course of business; and
  - includes similar information, opinions or recommendations with respect to a substantial number of companies in the issuer's industry or sub-industry, or contains a comprehensive list of securities currently recommended
- the research report is given no materially greater space or prominence in such publication than that given to other securities or registrants.

In those instances where the distribution agent does not already provide research coverage, a question may arise whether the distribution agent can commence research coverage during the term of the equity distribution program. Since there is little SEC guidance to rely on, it is helpful to rely on guidance issued by the Financial Industry Regulatory Authority, Inc. ("FINRA") regarding the commencement of research coverage preceding a follow-on public offering. A FINRA member cannot publish a research report on an issuer for which the FINRA member acted as a manager or co-manager of a follow-on offering by the issuer for 10 calendar days following the date of the offering (unless the issuer has elected to be treated as an "emerging growth company" under the Jumpstart Our Business Startups Act). In this case, the distribution agent may consider instituting a policy that it will not commence research coverage or provide a research report for a period of not less than 10 calendar days following the establishment of an equity distribution program.

The distribution agent likely will want to consider and institute guidelines regarding the review process that should be undertaken regarding research on the securities of issuers for which it is acting as an agent. These guidelines should include procedures for handling research reports that discuss earnings projections or a change in credit rating, as well as those reports issued outside the distribution agent's regular course of business.

Conflicts Issues

What are some common conflicts issues that arise in connection with at-the-market offerings?

The distribution agent also may wish to consider potential conflicts of interest that raise independence concerns and may arise in the following scenarios:

- *The distribution agent is rendering a fairness opinion for the issuer in connection with another transaction*. Generally, the distribution agent's activities as an agent for an equity distribution program will not raise any issues regarding its independence in the context of potentially rendering a fairness opinion. Note that when the SEC, FINRA and courts have considered the independence of financial advisors they have focused mainly on whether the financial advisor has received or will receive a success fee in connection with the consummation of the transaction at issue.
- *The distribution agent is acting as a financial advisor for the issuer in a restructuring of the issuer.* In this case, there is a greater likelihood of the SEC, FINRA or a court finding a conflict of interest.

Other conflict questions may arise during the course of the distribution agent's involvement as a distribution participant in connection with an equity distribution program. These questions often are difficult to anticipate and not amenable to any generalized policy, and thus must be dealt with on a case-by-case basis.

Regulation M

What restrictions does Regulation M impose on at-the-market offerings?

Regulation M is intended to protect the trading markets by prohibiting persons having an interest in a securities offering from undertaking certain actions in connection with the securities offering that could manipulate the market for the security in question. Rule 101 of Regulation M prohibits distribution participants and their affiliated purchasers from directly or indirectly bidding for, purchasing, or attempting to induce another person to bid for or purchase the subject security or any reference security until the applicable restricted period has ended. Rule 102 of Regulation M prohibits issuers, selling security holders and their affiliated purchasers from directly or indirectly bidding for, purchasing, or attempting to induce another person to bid for or purchase the

subject security or any reference security until the applicable restricted period has ended.

An at-the-market offering by an issuer of securities that qualifies as "actively traded" (i.e., average daily trading volume ("ADTV") of at least $1 million for an issuer with a public float of at least $150 million) is not subject to the restrictions of Rule 101. However, the restrictions of Rule 102 would still apply to the issuer and any selling security holders, and affiliated purchasers, unless the subject security is not issued by the issuer or any affiliate and the subject security has a reference security that itself qualifies as "actively traded." Generally, most at-the-market offerings are conducted for issuers that meet the ADTV test. In the case of securities that do not meet this exception, one must analyze each at-the-market offering based on its magnitude and whether it involves special selling efforts that would make it subject to Rules 101 and 102.

Note that Rule 104 of Regulation M prohibits stabilization activities in connection with at-the-market offerings. In addition, most at-the-market offerings are "best efforts" offerings, which are exempt from the short sale restrictions of Rule 105 of Regulation M.

Must the distribution agent file Regulation M notices with FINRA in connection with an at-the-market offering?

FINRA requires distribution agents to file Regulation M Restricted Period Notification Forms and related Regulation M Trading Notification Forms if the relevant transaction is a "distribution" as defined in Regulation M. FINRA has provided guidance in its "SEC Regulation M-Related Notice Requirements Under FINRA Rules Frequently Asked Questions" regarding the timing of filing of a Regulation M notice for an at-the-market offering program.

Liability Issues for At-the-Market Offerings

Does Section 11 liability attach to at-the-market offerings?

Yes, Section 11 liability attaches whether the issuer files a prospectus supplement to an already existing universal shelf registration statement or a new shelf registration statement specifically for at-the-market offerings.

The SEC's position has always been that Section 11 liability under the Securities Act attaches to the prospectus supplement to a shelf registration statement and the incorporated Exchange Act reports, but some commentators have disagreed. However, in 2005, the SEC adopted Rules 430B and 430C of the Securities Act in order to clarify that the information contained in a prospectus supplement required to be filed under Rule 424 of the Securities Act, whether in connection with a takedown or otherwise, will be deemed part of and included in the shelf registration statement containing the base prospectus to which the prospectus supplement relates.

Are at-the-market offerings subject to Regulation FD?

Yes, in some cases. Rule 100(b)(2)(iv) of Regulation FD exempts offerings registered under the Securities Act, except offerings registered under Rule 415(a)(i)-(vi) of the Securities Act. In the case of an offering under Rule 415(a)(i)-(vi), which would include an at-the-market offering, the issuance and delivery of the registration statement, the prospectus, the prospectus supplement and certain free writing prospectuses will not be deemed a violation of Regulation FD. Note that issuers usually do not file free writing prospectuses in connection with at-the-market offerings.

In general, ongoing and continuous offerings on behalf of selling security holders, including at-the-market offerings for insiders, will not be exempt from Regulation FD. However, ongoing and continuous offerings on behalf of selling security holders that also involve a registered offering, whether or not underwritten, by the issuer for capital formation purposes, will be exempt because Rule 415(a)(i) pertains to resale transactions "solely on behalf" of selling security holders. The reason for this diverging treatment lies with the SEC's concern that since registration statements involving only secondary sales are often effective and used for a very long period of time, an issuer could be effectively exempt from Regulation FD if the exclusion for registered offerings was applicable.

As of what date are prospectus supplements deemed included in the related shelf registration statement for at-the-market offerings? With respect to misstatements in the shelf registration statement, what is the new effective date of the shelf registration statement?

For prospectus supplements filed other than in connection with a takedown of securities, all information contained therein will be deemed part of and included in the shelf registration statement as of the date the prospectus supplement is first used. For prospectus supplements filed in connection with

takedowns, the relevant date is the earlier of (1) the date the prospectus supplement is first used or (2) the date and time of the first contract of sale for the securities.

For purposes of liability under Section 11 with respect to the issuer and any underwriter in connection with a shelf takedown, Rule 430B establishes a new effective date for the shelf registration statement, which is the date the prospectus supplement filed in connection with the takedown is deemed part of and included in the shelf registration statement as described above. Rule 430B also establishes a new starting date for the applicable statute of limitations under the Securities Act and eliminates the disparate treatment of underwriters and issuers resulting from the prior practice of assessing the issuer's liability as of the earlier initial effective date of the shelf registration statement.

Why are distribution agents expected to perform the same level of due diligence for an at-the-market offering as is performed for other underwritten offerings?

Rule 176 of the Securities Act sets forth several relevant circumstances for determining whether conduct constitutes a reasonable investigation or reasonable grounds for belief under Section 11(c) of the Securities Act, which defines the circumstances in which an underwriter's due diligence defense is available. These circumstances include:

- the type of issuer;
- reasonable reliance on officers, employees and others whose duties should have given them knowledge of particular facts; and
- with respect to facts or documents incorporated by reference, whether the particular person had any responsibility for those facts or documents at the time of filing of the documents from which they originated.

Courts have examined in recent litigation underwriters' due diligence obligations with respect to shelf offerings and have suggested that Section 11 requirements for underwriters have not been diluted despite the fact that (1) there has been a significant decrease in the amount of time underwriters have to perform due diligence, largely due to the fact that issuers now can incorporate by reference prior SEC filings, (2) underwriters often cannot provide input for those SEC filings incorporated by reference, and (3) underwriters often change from one shelf takedown to the next.

The SEC's historical commentary with respect to Rule 176 indicates that the implementation of the rule did not alter the fundamental nature of underwriters' due diligence obligations and that competitive timing and pressures are not relevant when evaluating the reasonableness of an underwriter's investigation.

Are the activities of a distribution agent more like ordinary dealer activities or underwriting activities of a statutory underwriter?

A distribution agent in an at-the-market offering can act as a principal or an agent. If the distribution agent acts on an agency basis, it will try to "place" the issuer's securities with investors, typically on a "best efforts" basis. In contrast, if the distribution agent acts on a principal basis, it will commit to purchase the issuer's securities for its own account with a view to reselling those securities, as if it were an underwriter in a traditional follow-on offering.

Even in the latter case, the activities of the distribution agent may more closely resemble ordinary dealer activities than underwriting activities of a statutory underwriter. First, the distribution agent executes sales of the issuer's securities through ordinary brokers' transactions, which do not involve any special selling efforts (*i.e.*, no road show or other solicitation) or an amount of the issuer's securities that would be considered significant relative to that issuer's public float or daily trading volume. The purchasing broker for an at-the-market offering also does not use any special marketing efforts. In contrast, traditional follow-on offerings typically are much larger than at-the-market offerings and the underwriter in a traditional follow-on offering engages in special selling efforts, either through a formal road show or the solicitation of potential investors. Second, the commission or spread payable by the issuer to the distribution agent (the purchasing broker receives no special selling commission) is similar to the commission payable to a dealer executing trades rather than the spread that would be payable to a broker-dealer acting as an underwriter in connection with a distribution. Note, however, that despite these differences, the distribution agent is still subject to Section 11 liability with respect to material misstatements or omissions in the shelf registration statement.

Miscellaneous

What is the difference between an "equity line of credit" and an equity distribution program?

Under an "equity line of credit," an issuer enters into a purchase agreement with an investor pursuant to which the issuer has the right (but not the obligation), during the term of the equity line of credit and subject to certain terms and conditions, to "put" its securities to the investor at a maximum offering price. An issuer's exercise of its put option is referred to as a "drawdown." One may also think of an equity line of credit as having characteristics of both a bank loan and a structured PIPE transaction. An issuer can structure the equity line of credit as (1) a registered offering, using a shelf registration statement, or (2) a continuous private placement, with a continuing obligation for the issuer to register the resale of the restricted securities sold to the investor under the equity line of credit.

The issuers that typically use equity lines of credit are the same issuers that engage in PIPE transactions, which generally are smaller public companies seeking additional growth capital, such as biotech companies and technology companies. Investors in equity lines of credit are similar to the investors that participate in structured PIPE transactions, which generally are not long-term investors. Equity lines of credit are a dilutive form of financing, may contribute to stock price volatility, and are negatively perceived by the market as financings of last resort.

Note that if the equity line of credit is structured as a continuous private placement, the SEC will treat each drawdown as an indirect primary offering due to the delayed nature of the offering and the fact that the investor is not "at investment risk" for the securities once the resale registration statement is filed. In these situations, the SEC will allow the issuer to register the "resale" of the securities before the issuer exercises its put option, but only if the transactions satisfy the following conditions:

- except for conditions outside the investor's control, the investor is irrevocably bound to purchase the securities once the issuer exercises its put option;
- the registration statement must be on a form that the issuer is eligible to use for a primary offering; and
- in the related prospectus, the investor must be identified as an underwriter, as well as a selling security holder.

If these conditions are not met, the SEC will still allow the issuer to register the securities for resale so long as (1) the issuer is "primarily eligible" to use Form S-3 (or Form F-3 for foreign private issuers) and (2) the issuer discloses in the related prospectus any issues regarding the potential violation of Section 5 of the Securities Act in connection with the private placement. For more information regarding primary eligibility, *see "What does it mean to be 'primary eligible'?"*

Are there any separate considerations for issuers that are closed-end funds?

A closed-end fund is a type of fund that has a fixed number of shares usually listed on a major stock exchange. In contrast to open-end mutual funds, closed-end funds (1) do not issue and redeem their shares on a continuous basis and (2) often sell their shares at a discount from net asset value ("NAV") since the managers of closed-end funds are perceived by the market to be less responsive to profit opportunities. Note that closed-end funds are "investment companies" under the Investment Company Act of 1940 ("1940 Act").

If an issuer is a closed-end fund that is considering at-the-market offerings and/or establishing an equity distribution program, then there are a number of additional considerations. First, although the closed-end fund issuer may rely on SEC no-action letter guidance (*i.e.*, Pilgrim and Nuveen) to register shares for sale pursuant to Rule 415 on Form N-2, the closed-end fund issuer cannot rely on the "access equals delivery" model *(i.e.*, Rules 172 and 173 of the Securities Act). Second, the closed-end fund issuer may have a FINRA filing obligation regarding the compensation arrangements for the at-the-market offerings and/or equity distribution program. Third, Section 17 of the 1940 Act may impose restrictions on the activities of distribution agents that also serve as "underwriters" for the closed-end fund issuer. Fourth, a closed-end fund generally cannot issue below its NAV. Fifth, the closed-end fund issuer and the distribution agent also will want to consider whether both the closed-end fund issuer and its adviser should be parties to the distribution agreement and both should make representations and warranties, and undertake covenants, in the agreement. Sixth, the closed-end fund issuer and its counsel will want to consider the requirements to update the Form N-2 registration statement (given that Form N-2 does not provide for incorporation by reference), and consider obtaining a Rule 486(b) no-action letter that will permit the filing of post-effective amendments (not subject to review) solely for this purpose.

What effects do ongoing repurchase programs and dividend reinvestment programs, or "DRIPs," have on at-the-market offerings?

Prior to conducting at-the-market offerings and/ or establishing an equity distribution program, an issuer should check whether it has in place any ongoing repurchase programs or DRIPs. An ongoing repurchase program is a program under which an issuer purchases or buys back, either directly or indirectly, its own shares in the open market, mainly to help increase shareholder value when its outstanding securities are perceived to be underpriced or minimize the dilution caused by the use of stock in acquisitions or for employee benefit plans. A DRIP is a program under which an issuer automatically reinvests shareholder dividends in additional shares of the issuer's stock, often at a discount to the market price, and with the issuer often absorbing any applicable brokerage fees.

If the issuer has any ongoing repurchase programs or DRIPs in place, there are two additional considerations. First, for purposes of satisfying any requirements under Regulation M and in order to address other potential market manipulation concerns, the issuer should plan its equity distribution program carefully and even consider suspending share repurchases and/or dividend reinvestments or limiting equity distribution programs and share repurchases and/ or dividend reinvestments to pre-defined "window" periods. Second, if the issuer intends to set up multiple equity distribution programs, each using different distribution agents, the issuer should take care to ensure that different agents are not selling the issuer's securities during the same window periods.

Are there any legal considerations applicable to Canadian issuers conducting at-the-market offerings?

Canadian issuers seeking to take advantage of the U.S./Canada Multijurisdictional Disclosure System (MJDS) to conduct at-the-market offerings in the United States must file a base shelf prospectus with the Canadian securities regulators and a corresponding shelf registration with the SEC. Once the final base shelf prospectus has been approved by the Canadian securities regulators and the issuer's registration statement has been declared effective by the SEC, the issuer must then file the prospectus supplement disclosing the terms of the at-the-market offering. Under Canadian regulations, the market value of shares distributed under any single prospectus supplement may not exceed 10% of the aggregate market value of the issuer's outstanding shares.

In addition, Canadian issuers must apply for relief from the requirement under Canadian securities laws that broker-dealers effecting transactions in an issuer's securities deliver a prospectus to purchasers of those securities (in contrast to the "access equals delivery" principles of Rule 172 of the Securities Act applicable to U.S. issuers). Issuers must also apply for exemptive relief from Canadian securities regulators in respect of the requirement to include in the Canadian prospectus supplement a statement of purchasers' statutory rights in the prescribed form as well as the requirement to include in the prospectus supplement a certificate of the issuer in the prescribed form. Canadian securities regulators have typically granted the relief described above as a matter of course, although the relief has historically been provided based on a cap on the number of shares sold on the Toronto Stock Exchange (the "TSX") on any trading day equal to 25 percent of the trading volume of the shares on the TSX on that date. Exemptive relief from Canadian securities regulators is not required where at-the-market offerings will only be effected on a U.S. securities exchange (*e.g.*, the NYSE and Nasdaq).

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