Securities Offerings During Closed Windows and Blackout Periods

March 27, 2020

Many of our clients are taking a close look at their sources and uses of cash over the next several quarters and beyond in the face of a potentially prolonged period of market and business uncertainty associated with the coronavirus (COVID-19) pandemic. In a turbulent market, many public companies and their underwriters want to be prepared to take advantage of potential opportunities to raise debt or equity capital, even if they occur during a company's self-imposed blackout period.

During a blackout period, company insiders are barred — as a matter of company policy — from trading in the company's securities. These blackout periods typically begin before the quarter ends and continue until shortly after the quarter's earnings announcement.

Companies choose to impose blackout periods on their insiders as a prophylactic measure to prevent the appearance that securities were sold at a time when their insiders had material non-public information or "MNPI" about the company. The existence of a self-imposed blackout period does not, however, as a legal matter, prevent a company from selling securities, as long as the company has provided adequate disclosure.

This memo discusses what factors public companies and their underwriters should consider when contemplating a securities offering — including equity, equity-linked or debt offerings and PIPE (private investment in public equity) transactions — during a blackout period.

What is a blackout period and why do companies impose them?

The securities laws in the U.S. and other jurisdictions prohibit insiders from trading based on any material non-public information they have obtained from the company. Accordingly, public companies typically require insiders who wish to sell securities to obtain clearance from the legal department before trading to ensure they don't possess MNPI. To protect insiders from regulatory investigations and the possible appearance of impropriety, as well as to avoid forcing the general counsel to make a call when the facts may be developing rapidly, most companies impose a blackout period during which insiders cannot trade. This period often starts before quarter-end, when the company and its insiders are likely to possess MNPI. But, importantly, this is a preventative measure, not a hard-and-fast rule imposed by law or regulation.

Can an offering be completed during a blackout period?

At the risk of repeating ourselves, there is no legal prohibition on the sale of securities during a regularly scheduled blackout period. Rather, issuers have disclosure obligations to purchasers at the time of an offering and sale of securities, and information about the company's performance for a nearly-completed or recently-ended fiscal quarter as well as trends impacting the business is often judged to be material information. And even though companies typically take pains to exclude forward-looking guidance or projections from the information provided to investors in the context of an offering, a company's failure to "meet or beat" expectations when earnings are announced is likely to result in a stock drop and could lay the groundwork for claims that the issuer misrepresented or failed to disclose underlying trends in the business at the time of the offering.

It may be possible to complete a securities offering during a blackout period when:

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- management has enough information about the current (or recently ended) quarter to be able to predict with a fair degree of confidence what the company's reported results are likely to be;
- management has a good track record of being able to judge its anticipated results at similar points in the information-gathering and reporting cycle;
- management's expectations for the quarter, and future periods, are either (i) at least in line with "the market's" expectations as well as with management's own previously announced guidance (if any) - or (ii) if management's expectations are not so in line, the company and its underwriters conclude that the deviation is not material or the company is willing to "pre-release" its current expectations prior to the earnings release. In certain circumstances, such as those relating to the impact of the COVID-19 crisis, management may not be able to predict the company's results beyond the current quarter, with a high degree of confidence. In those scenarios, a company may decide to withdraw previously issued guidance and not issue new guidance. Nevertheless, withdrawing guidance is not a substitute for disclosure of underlying trends and uncertainties that could affect financial and operational performance; and
- management's analysis of the going-forward impact on the company's business of COVID-19 is sufficiently developed that disclosure can be made at the time of the offering that will be in line with what is disclosed when the 10-K, 20-F, 10-Q, 6-K or other filing is made.

Management's information. The inquiry into management's current information should normally include careful diligence focusing on the "known knowns" and the "known unknowns," and an effort to quantify the "known unknowns" is usually essential. The "unknown unknowns," of course, cannot be quantified, and for this reason *all participants in the transaction must understand and accept that there is some quantum of risk – reputational as well as legal – that cannot be excluded when conducting a securities offering in the period leading up to the company's formal announcement of results*. Some companies have systems (such as flash reports) to track performance weekly, or even daily, and have a strong grasp on what is happening on a near real-time basis. Other companies may experience more of a lag before negative information or a developing negative trend becomes apparent to management – the "unknown unknowns" would be more of a concern here. Today, many companies are just starting to assess the effects of the COVID-19 pandemic and are considering the limited nature of the information they've gathered so far in light of the rapidly evolving environment.

Management's track record. An assessment of management's track record can sometimes be informed by comparing the company's earnings or other forward-looking guidance to its reported results for the last several quarters, in order to get a sense of whether the company has a history of "underpromising and overperforming," or vice versa. Not all companies provide public guidance, however. For companies in either camp, it is usually helpful to have a working group discussion focusing on where the company is in its information-gathering and reporting cycle, and whether it is currently at a point, based on past experience, to be able to forecast results with some degree of accuracy.

Market expectations. Market expectations are not always easy to discern, and there is no single way to go about determining them. Many working groups will start with services such as Thomson One, or another service that aggregates the published views of securities analysts, in order to determine the "consensus" view for the current (or recently ended) quarter, the full year and sometimes the next year. Because the consensus is usually reported as an average (whether of estimates of future revenues, earnings, EPS or EBITDA, or other metric closely followed in the company's industry), it is usually helpful to look beneath the consensus to see whether it is being driven up or down artificially by an analyst or two who may be an outlier. Likewise, if the company will meet market expectations largely because of one or more factors that the market is unaware of, or may be aware of but is likely to discount (such as a one-off or non-operating gain), and the company would be below expectations if its results were based only on the factors normally incorporated in the analysts' models, the working group may decide that the company is not clearly and comfortably meeting market expectations despite a superficial similarity.

Because most analysts do not update their published views more frequently than quarterly, sometimes the "consensus" may be outdated. As an example, if the company is a brick-and-mortar retailer and its earnings will deviate from consensus simply because sales have declined due to previously announced store closures since the analysts last published, the working group may be able to conclude that investors will not be surprised by the deviation. However, for each offering, the working group should try to understand whether the reason the company is likely to deviate from consensus, and the magnitude of that deviation, is something that ought to be apparent to and expected by the investing public or is instead based on information not available to the market.

Beyond looking at the numbers, the company and its underwriters should consider any other available information, such as:

- the company's understanding of where investors and analysts are currently focused,
- the views of coverage bankers involved in the transaction,
- recent announcements by industry peers or others that may be recalibrating market expectations, and
- the views of any sell-side research analysts who are "over the wall" - i.e., an analyst employed by an underwriter involved in the transaction who has been informed about it. Because an analyst who is brought over the wall is usually prohibited from speaking to investor clients about the company until the transaction has been publicly announced, it is generally not customary to bring analysts over the wall until shortly before announcement.

A company that does not provide public guidance or that has withdrawn its public guidance may reasonably ask why market expectations about the company's upcoming earnings announcement should be relevant to the question of whether it can conduct a securities offering. The issue is whether or not investors are likely to be disappointed when the company announces earnings. Even if the company does not provide or has withdrawn guidance, the market still has expectations, generally based on the company's results in prior periods; the fact that those expectations were not informed by the company's own guidance is a nuance that may be lost on the disappointed investors and the plaintiffs' lawyers who specialize in filing lawsuits on their behalf.

What if management's expectations are not in line with the market's?

If management's expectations for the quarter are not in line with the market's, many companies will decide to put off a securities offering until after earnings are announced and the related 10-K, 10-Q or 6-K is filed. For a company that is nevertheless prepared to proceed, the company and its underwriters should agree on a strategy for recalibrating the market's expectations. This involves two decisions: what to say, and how to say it.

What to say. This, of course, turns primarily on the facts. Frequently, the issue is simply a non-trivial risk that one or more of the company's reporting metrics will be lower than the market's current expectations. Sometimes this can be solved simply by disclosing or highlighting a fact or trend (such as a slowdown in orders from a major customer or a supply chain disruption) that the market has not previously considered or that analysts have not yet factored into their reports. Often, the company cannot say precisely what it will report in a few weeks, but is fairly certain that the market's expectations are above the range of reasonably likely outcomes; in this case it may be appropriate to disclose that range. In situations where the longer-term effect of a trend is unknown, it may be appropriate to withdraw longer term guidance, such as annual guidance, and instead qualitatively discuss the trends and impacts currently being experienced.

How to say it. Because of the sensitive nature of information about a gap between management's and the market's expectations, the communication strategy should take into account the requirements and

spirit of Regulation FD – even when there is a technical Regulation FD exemption, as may be the case with a public offering. Thus, companies will often announce the new information in an 8-K or 6-K filed immediately prior to launching the transaction. If the quarter-end has passed, disclosure under Item 2.02 may be needed; otherwise an Item 7.01 8-K or press release may suffice. Whether to also include (or incorporate by reference) the information in the offering document and/or road show materials is a subject for working- group discussion. When the information includes forward-looking statements, the working group may conclude in some situations that it is preferable to leave it out of the offering materials.

What else should the working group consider?

Updates to risks, trends and uncertainties. Particularly in a volatile macroeconomic environment, “meeting or beating” guidance and street expectations should not be the only yardstick for up-to-date disclosure in the context of a securities offering. As an example, a company that expects to meet its guidance for the recently completed quarter and that does not provide full year guidance needs to consider whether it is aware of underlying trends in its business that could weigh on the outlook that it provides in its next earnings call. If an issuer is incorporating the MD&A and Risk Factors sections of its previous 10-K, 20-F, 10-Q or 6-K by reference in its offering document, it should carefully examine whether the risks, trends and uncertainties disclosed in that incorporated filing are accurate and complete as of the date of the offering. And if a company updates its risk factors or other disclosure in an offering memorandum relating to an unregistered offering, it should consider whether the changes are material such that they should also be publicly filed on Form 8-K or 6-K, as applicable. In light of the COVID-19 pandemic, issuers that have not already done so in an 8-K or 6-K filing may update their risks, trends and uncertainties disclosure in the upcoming 10-K, 20-F, 10-Q or 6-K. In the context of an offering carried out before that filing, it will be important for the offering disclosure to be in line with what will be reported in the future filing.

Selective disclosure issues. Companies conducting confidential marketing of securities, such as in a wall-crossed registered equity offering or a PIPE, are likely to grapple with challenging Regulation FD questions in a rapidly changing business environment. In order to participate in a confidential marketing process, investors agree to keep confidential any MNPI that they receive and not to trade in the company’s securities until an agreed future cleanse date. On or before the cleanse date, the issuer must either broadly disclose the confidential information to the market, such as in a press release or 8-K, or determine that the non-public information is no longer material.

The very existence of a contemplated equity offering is ordinarily MNPI; in fact, in many wall-crossed registered equity offerings, it is often the only MNPI that the investor receives. If an issuer has sufficient cash or access to financing, companies and their advisors often conclude that a proposed offering is “opportunistic” — meaning that if the issuer abandons it, the abandoned attempt to raise capital is not material information, and no cleansing disclosure will be required. In a volatile market in which both access to financing and projected expenses are uncertain, these judgments are more difficult and could even change through the course of the confidential marketing.

In certain circumstances, investors may be unwilling to indicate interest in a proposed offering without receiving additional, current information about the issuer’s estimates or outlook — information that is almost certain to be considered MNPI. This is particularly true in a PIPE, in which one or more investors purchase a relatively sizable equity stake in the company. In such situations, issuers will need to carefully consider whether and when to share such information in the confidential marketing process and to be cautious about any cleansing requirements from potential PIPE investors.

Reputational risks. All offering participants – the company and company management as well as the underwriters – risk damage to their reputations if an offering is conducted and the company’s subsequently reported results disappoint investors in the offering. This is the case whether or not the company felt it needed to disclose new information in order to reset the market’s expectations.

Legal risks. A materially disappointing earnings release issued after an offering can be an invitation for a lawsuit, which of course is distracting and potentially costly even if not well-founded. The working group should bear in mind that whether there's a "material" difference between the company's offering-related disclosures and its subsequently announced results is a question that will be judged with hindsight – based at least in part on how the market reacts when the results are made public.

On a related note, the company's accountants generally will not be in a position to provide "comfort" with respect to ranges or projections, and may be unable to provide comfort with respect to periods of a few weeks before and after the quarter-end. Similarly, prior to filing the 10-K, 20-F, 10-Q or 6-K, the company's accountants are generally unable to provide a formal review or audit of financial information for the quarter or year. In a subsequent lawsuit, therefore, the offering participants may not have the full benefit of an accountant's comfort letter to help establish their due diligence defense. Underwriters will therefore often seek to document and substantiate their diligence of ranges, projections, earnings-release information and other financial information about the quarter through alternative means, such as by conducting meetings with the company's management and senior accounting personnel to discuss the basis for the company's expectations, obtaining a CFO certificate attesting to numbers or ranges included in the offering document and/or having a confirmatory conversation with a member of the company's audit committee, in addition to obtaining the company's representations and warranties in the underwriting or purchase agreement and reviewing read-outs from financial systems. Though the exact procedures may vary from situation to situation, it will be important to demonstrate that a robust process of vetting management's expectations and underlying assumptions for the quarter and future periods was undertaken with the participation of the working group.

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