Introduction to PIPE Transactions

PIPE Basics

What is a PIPE transaction?

- A **PIPE** (Private Investment in Public Equity) is the privately negotiated sale *(i.e.*, a private placement) of a public issuer's equity or equity-linked securities to selected accredited investors, where the sale is conditioned upon a resale registration statement being filed with, and declared effective by, the SEC (permitting immediate or prompt resale).
- Investors enter into a purchase agreement to buy securities. The purchase agreement, or a separate registration rights agreement, provides that the issuer is required to file a resale registration statement covering the resale of the purchased securities (or the shares of common stock underlying the purchased securities).
- Designed to enable a public company to issue equity or equity-like securities to investors more rapidly than in a typical registered offering.
- Usually consists of "primary shares," but may also be in the form of a "secondary offering," or a "primary/secondary" offering.

PIPEs: changing terminology

"PIPE" has come to mean any private investment in a public company, including:

- A traditional PIPE;
- A private placement with delayed (or trailing) resale registration rights;
- A private convertible preferred (fixed or floater) or structured PIPE;
- A venture-style, or change-of-control, private placement;
- A registered direct; and
- A private "equity line" or equity shelf program.

Who invests in PIPEs?

- "Accredited investors."
- Funds, including hedge funds, mutual funds, pension funds, etc., are frequent PIPE investors.
- Sector and institutional buyers.
- More recently, venture funds and private equity firms have expanded their participation in PIPE transactions.
  - In the case of private equity firms, this is largely a response to the lack of availability of credit for effecting the leveraged transactions that are core to their business.
  - Venture capital funds have increased their participation in PIPEs because valuations have dropped and issuers have become willing to give them terms that are found in venture capital private transactions.
  - Venture and private equity funds often seek to negotiate additional covenants in the purchase agreements relating to corporate governance rights and information rights.

What types of securities are sold in PIPE offerings?

- Common stock
- Convertible preferred stock
- Convertible debt
- Warrants
- Other equity or equity-like securities of an already-public company
- A combination of these securities

Advantages of PIPE transactions to the issuer

- Lower transaction expenses compared to a registered offering.
- Increased holdings among institutional and accredited investors.
- Usually requires disclosure of the transaction to the public only after definitive purchase commitments are received from investors.
  - Issuer seeks to improve the pricing of the transaction by preventing shorting and other speculative trading activity before the announcement.
  - The transaction form generally doesn't work in non-U.S. jurisdictions in which investors have pre-emptive rights over the issuance of new securities.
- Requires preparation by the issuer of relatively limited offering documentation.

Disadvantages of PIPE offerings to the issuer

- Investors almost always require a discount to the market price, due to limited liquidity. May also require warrant coverage.
- Note: 2008 amendments to Rule 144 shorten the restricted period. Six-month maximum holding period for non-affiliates, if the issuer complies with the "current information" requirements of the rule.
  - The amendments were intended in part to reduce the liquidity discount.
- Limited to accredited investors.
- Limit on the number of "blackout periods" under the registration statement.
- "20% Rule."

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Two Types of PIPEs

- Traditional PIPEs
  - Investors commit to purchase a fixed amount of securities at a fixed price, with the closing conditioned mainly upon the SEC's readiness to declare effective a resale registration statement registering the underlying common stock sold.
- Private placement with trailing registration rights
  - Private placement of securities. Issuer effects the registration **after** the closing of the private placement.

Private placement with trailing resale rights

- Structured as a private placement with follow-on (or "trailing") registration rights.
- Once investors enter into a definitive purchase agreement, closing can occur.
- Post-closing, the issuer is obligated to file a resale registration statement and to use its best efforts, commercially reasonable efforts, or some other negotiated standard, to have it declared effective by the SEC.
- Typically, the purchase agreement, or a separate registration rights agreement, outlines specific deadlines for the issuer to file, and then to seek effectiveness of, the resale registration statement.
  - Many transactions include a requirement that the issuer make penalty payments if it fails to meet the deadlines set for filing or effectiveness, or both.
  - The investor may not have the benefit of a registration statement for some time (often, 60 to 90 days following the closing. As a result, investors will hold restricted securities for some period of time.

Private placement with trailing resale rights *(cont'd)*

- The purchase agreement/registration rights agreement generally contains a limitation on black-out or suspension periods.
- The purchasers are named in the resale registration statement as "Selling Stockholders."
- The resale registration statement is usually kept effective until all of the shares may be sold without limitation under Rule 144.
  - As mentioned above, many agreements require that the registration statement be kept effective for a maximum period of one or two years. If affiliates participate as investors they often reject the maximum period.

Private placement with trailing resale rights *(cont'd)*

- The purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement).
- The purchase agreement may, depending on the nature of the investors, contain ongoing covenants relating to corporate governance (board representation or observer rights, blocking rights, etc.) or information requirements (regular deliveries of public filings or other information to investors).
- The investors typically receive only legal opinions.
- Closing conditions are limited to no occurrence of any material adverse change between signing and closing, and the delivery of the required legal opinions and closing documents.

PIPE Documentation

Key documents in a PIPEs offering

- Engagement letter between issuer and placement agent
- Offering materials or reliance on SEC filings
- Purchase agreement/registration rights agreement
- Legal opinions
- Comfort letter
  - Typically addressed only to the placement agent
  - May or may not be required by the placement agent
- Closing documents
- Press release/Form 8-K
- Resale registration statement

Engagement letter

- This is often the only binding agreement between the issuer and the placement agent
- Placement agent's fees
- Exclusivity period — "tail"
  - Frequent subject of negotiation: As to which investors does the issuer pay the placement agent? What is the duration?
- Indemnification
- Conditions precedent — will placement agent receive a comfort letter?
- When working on a PIPE, or a follow-on offering, review the issuer's prior PIPE engagement letters (or engagement letters for similar transactions, whether or not closed), to see if a "tail" is applicable to the new transaction.

Purchase agreement

- Agreement is between the issuer and the investors.
  - Placement agent is not usually a party, unless it is also investing.
- Issuer representations and warranties
  - Investor will not have material non-public information once the transaction is announced.
- Issuer covenants to promptly make the transaction public.
- Investor representations (limited):
  - Private placement reps; "accredited investor."
  - Confidentiality, no violation of the securities laws.
  - Conditions to closing.
- Very often, provisions from the issuer's prior underwriting agreements and similar documents may have very useful provisions, such as many of the representations and warranties, some of the legal opinions, etc.

Negotiating the registration rights

- Limitation on the length or number of black-out periods?
- Usually no “piggy-back” registration rights.
- Will there be a time limit for filing of the resale registration statement following execution of the purchase agreements?
- Length of time given for the issuer to have the resale registration declared effective?
- Penalty payments for failure to file registration statement or to go effective? Cap on the amount of payments?
- Can any other registration statement be declared effective before the registration statement relating to the PIPE?

PIPE offering materials: disclosure

- At times, a private placement memorandum is prepared containing, or incorporating by reference, the issuer's Exchange Act documents
- Investors rarely receive projections or other information that has not been disclosed publicly
  - Having MNPI would limit their ability to deal in the shares after the closing
- If there is a reason to provide investors with MNPI, the purchase agreement will often contain a covenant requiring the issuer to disclose such information to the public when the offering is announced or at some other relevant time
- Sometimes, PIPEs are marketed without a disclosure document, such as when the investors are familiar with companies in the issuer's sector. A term sheet with the proposed terms of the offered securities is sometimes the only document circulated

Resale shelf registration statements

- An issuer generally does not need to be S-3 eligible on a **primary** basis to complete a PIPE transaction. An issuer may use a Form S-1 or a Form S-3 registration statement as a resale shelf registration statement in connection with a PIPE transaction.
  - But…see below re the SEC's analysis.
- However, using a Form S-3 for the resale registration statement is less costly and less time-consuming, since the Form S-3 is less burdensome and may be updated by the periodic filing of Exchange Act reports, without the need to file post-effective amendments. An issuer must be eligible to use Form S-3 on a resale basis.
- Key due diligence point for investors and placement agents (as well as a representation in the purchase agreement, and a legal opinion): is the issuer S-3 eligible?

Use of an existing registration statement

- Generally, if an issuer has a shelf registration statement on file, it is a primary shelf registration statement for the sale of newly issued securities and therefore, of no use for an issuer looking to effect a PIPE transaction.
- For a PIPE, the issuer is required to file, and have declared effective, a resale registration statement covering the resale by the PIPE purchasers (a selling stockholder shelf registration) from time to time of the securities that were purchased in the PIPE transaction.
  - Exception: WKSIs — may add securities issued in a PIPE to an existing shelf.

Issues re S-3 eligibility

- Problem: issuers that attempt to use an S-3 as a resale shelf but are not eligible to use the S-3 on a primary basis. PIPE transaction results in a "disproportionate" increase in total shares outstanding.
- Question: is the transaction properly characterized as a "resale"?
- If issuer cannot use Form S-3, it must use a Form S-1, and must file post-effective amendments to keep the information current (no forward incorporation by reference).
- SEC's "rule of thumb": 33% of the public float:
  - Amount of time the shares have been held.
  - How did the investors receive the shares?
  - Relationship to the issuer.
  - Number of shares involved.
  - Are shareholders underwriters or broker-dealers?
  - Are the investors acting as a "conduit" for the issuer?
- Recent reports suggest that the SEC will allow registration of more than 33% of the public float if the securities issued are common stock or have fixed conversion or exercise prices (i.e., no death spirals or toxic converts). Also, the SEC will be more flexible if the investors are long-term investors, such as venture capital funds.
- Many issuers that face this issue register the maximum amount of shares the SEC allows (on a secondary basis) and then, after six months, register more (SEC guidance requires that the original tranche be sold before more shares are registered); more often the sellers rely on Rule 144 as six months have passed.

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PIPEs and Regulation FD (Fair Disclosure)

- An issuer is owed a duty of confidence from its agents, such as its placement agent, accountants, and other similar participants in the PIPE process. In contrast, an issuer does not share with potential investors any information that has not already been included in the issuer's Exchange Act reports.
- A private placement memorandum for a PIPE transaction usually contains the issuer's Exchange Act reports, together with legal disclaimers. It is prudent to limit the information contained in the private placement memorandum unless the issuer will be receiving signed confidentiality agreements. Although the issuer is not sharing material nonpublic information about the issuer's business with potential PIPE investors, the issuer is sharing its plans concerning a potential financing transaction. **The fact that the issuer is contemplating a PIPE transaction may itself constitute material nonpublic information.**
- The issuer should ensure that, before the placement agent reveals the issuer's identity, the placement agent obtains an oral agreement from each potential purchaser it contacts that information shared will be kept confidential. This oral agreement may be documented subsequently through an acknowledgement and a covenant in the purchase agreement.
  - Some placement agents use "omnibus confidentiality agreements" with frequent PIPE investors which are confirmed in connection with each PIPE.

Closing a PIPE – physical certificates

- Note: some investors, such as certain types of mutual funds and other investment funds, must close offerings electronically on a “delivery vs. payment” basis, and may not accept physical stock certificates at closing.
- Determine early if any investors of this kind will be participating in your offering, and prepare the settlement mechanics and related provisions for the transaction documents accordingly. Shares will need to be issued by the transfer agent prior to the closing, and held by a “custodian.”

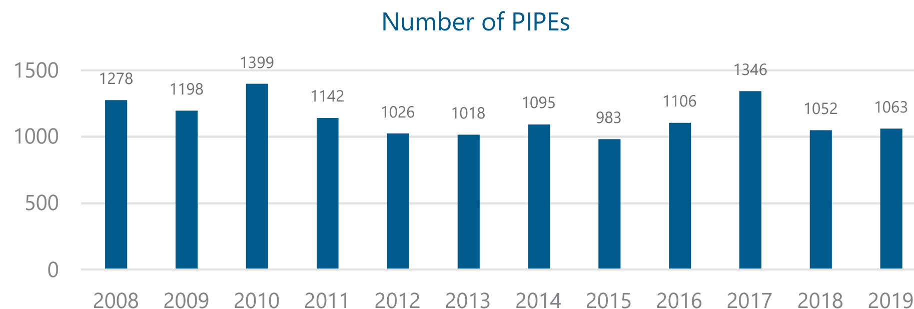
Market Trends

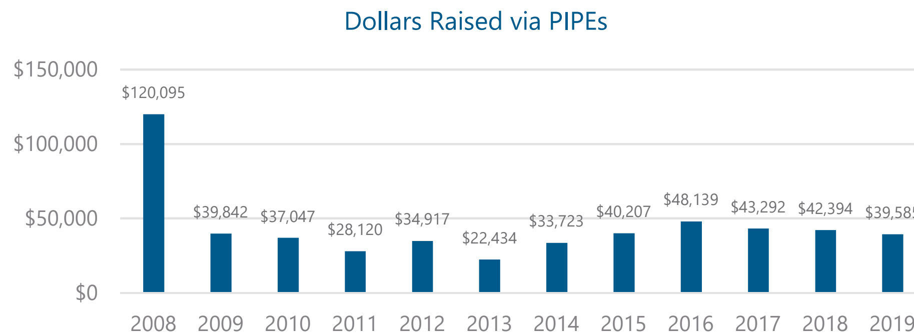
Market trends

- Trends affecting the market for PIPE transactions include the following:
  - Most transactions now take the form of shelf takedowns.
  - Most shelf takedowns are either pre-marketed (wall-crossed) offerings or marketed on an accelerated basis rather than traditionally marketed underwritten offerings.
  - Some shelf takedowns are structured as registered direct offerings.
  - PIPE transactions have declined in number, but they remain useful under certain circumstances.

PIPE market trends

Year	Number of PIPEs	Dollars Raised
2019	1063	$39.6 billion
2018	1052	$42.4 billion
2017	1346	$43.3 billion
2016	1106	$48.1 billion
2015	983	$40.2 billion
2014	1095	$33.7 billion
2013	1018	$22.4 billion
2012	1026	$34.9 billion
2011	1142	$28.1 billion
2010	1399	$37.1 billion
2009	1198	$39.8 billion
2008	1278	$120.1 billion





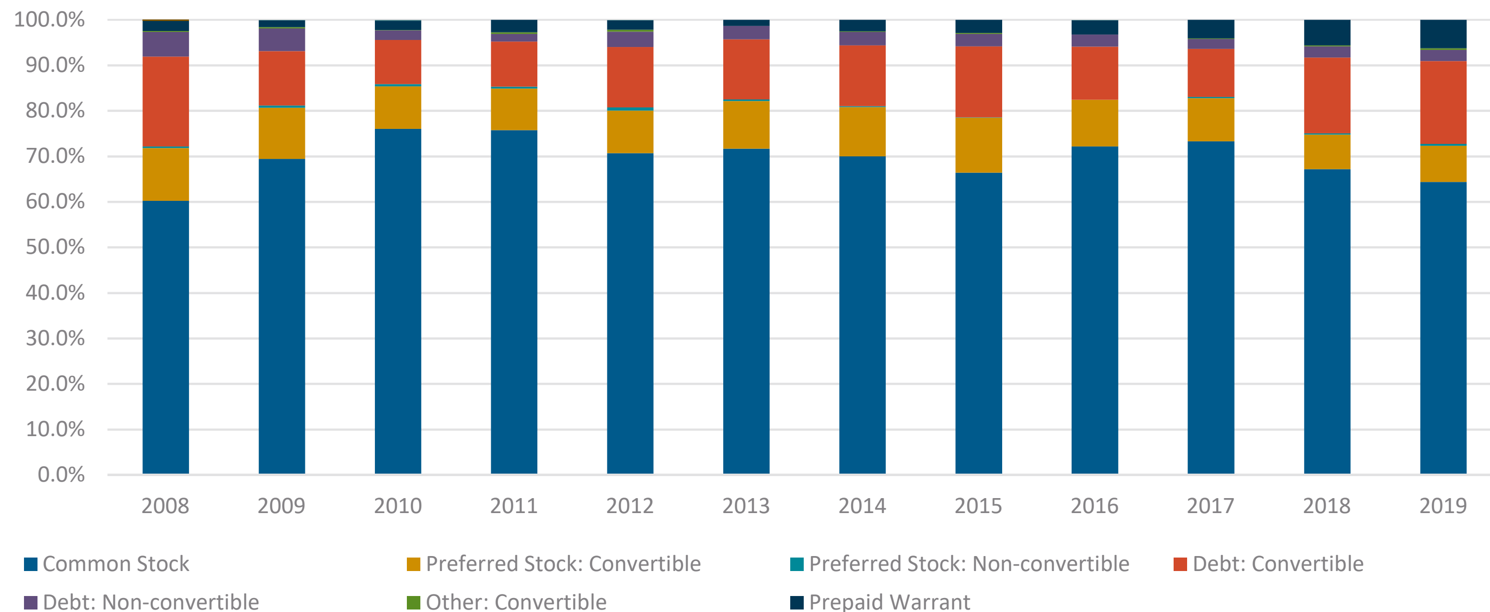
Data: PrivateRaise.com

PIPEs by the Numbers, 2019

Security Type	(# of placements)	($ millions raised)
Common stock	685	$17,110
Preferred stock: Convertible	84	$6,001
Preferred stock: Non-Convertible	5	$10,665
Debt: Convertible	193	$4,432
Debt: Non-convertible	26	$543
Other: Convertible	4	$265
Prepaid warrant	66	$569
Total	1063	$39,585

Data: PrivateRaise.com

PIPEs: Structure breakdown



Are PIPEs Still Relevant?
When Is A Registered Offering Better?

Strategic uses of PIPE transactions

- PIPE transactions remain an important alternative in a number of instances, including:
  - As a means of structuring a venture capital or private equity-type investment (which may take place in a distressed context or during periods of market volatility)
  - In circumstances where the issuer is seeking to finance an acquisition
  - For a smaller issuer, when the smaller issuer has already tapped out its shelf registration statement or needs to preserve its shelf capacity
  - For selling stockholders (to place selling securityholder stock in an orderly way)

VC/Private equity PIPE

- Venture capital or private equity funds will often invest in public companies — either to increase their position or as a new investment if valuations make it attractive.
- Often a VC or a PE fund will invest in a public company as part of a recapitalization transaction.
- Why should these be structured as PIPE transactions?
  - Highly customized security;
  - Usually the investor will want to do its own diligence and is likely to acquire material and non-public information that will not be capable of being disclosed by the issuer after the transaction is completed (so the VC/PE firm will continue to be restricted);
  - The investors will likely want other contractual protections (affirmative/negative covenants, information rights);
  - The investors may want board representation;
  - The investors will not be as focused on their resale opportunities or if they are insiders/control persons will face other limitations

VC/Private equity PIPE *(cont'd)*

- These deals raise a host of issues that usually do not arise in other PIPE transactions:
  - Change of control issues:
    - Company's agreements
    - Poison pill/rights plan
    - Nasdaq or other change of control provisions
  - Dilution for other shareholders and litigation risk
  - Change of control premium issues
  - Fiduciary duty and other governance issues
  - Fairness opinions

PIPE to finance an acquisition

- Why a PIPE?
  - Marketing reasons:
    - It may be important to share with potential purchasers a fair bit of information about the acquisition (all material non-public information) and restrict their ability to trade for an extended period of time
    - Important to assess when this information will be shared broadly and/or when the information will become stale
  - Lack of "current information:"
    - Is the acquisition material?
    - Is pro forma information required to be filed?
    - Pro forma information may not be available
    - A comfort letter may not be available that could cover the financial information
  - These considerations may make it impossible to undertake a registered offering

PIPE to finance an acquisition *(cont'd)*

- Company would like to raise capital in advance of knowing whether its bid has been accepted
- Private placement option
  - Company will conduct a private placement to institutional investors
  - Placement agent will wall cross institutional investors and institutional investors will agree not to trade in issuer's stock (and, if public, in the target stock)
  - Placement agent and Company will share with investors that are wall-crossed a PPM (or other offering materials)
  - Use of proceeds will describe potential acquisition — at least two alternatives:
    - Possible for proceeds to be escrowed and released only if Company is winning bidder, or
    - Proceeds would be released to Company regardless of whether Company prevails and wins the bid. Company would use proceeds for future acquisitions.

PIPE to finance an acquisition *(cont'd)*

- There are a number of special considerations if Company will pursue a private placement
  - Discount: will investors insist on a discounted price?
  - "Lock up": will investors agree to be prevented from trading for a sufficiently long period of time? When will Company put out a release after definitive purchase agreements are executed? What will it say? What if the acquisition falls through? How will investors be cleansed?
- Liquidity: Investors will be focused on how quickly they can obtain liquidity
  - Company will need to agree to prepare and file a resale registration statement that covers the resale from time to time of the securities sold to investors in the private placement
  - Company and counsel will need to consider carefully the significance of the acquisition and, if significant, how long it will take to prepare the required historical financials and pro forma financials

PIPE to finance an acquisition *(cont'd)*

  - Investors may exact a more significant discount if the periods to file a resale registration statement and/or to have the resale registration statement declared effective are longer than they would expect (typically period is usually 30 to 60 days)
- Securities exchange rules: Nasdaq, NYSE, and NYSE American impose shareholder vote requirements in various instances
- Big boy letters:
  - The investors should acknowledge receipt of information on target or the fact that they have not received combined financials

PIPE for smaller issuer

- Smaller issuers are subject to the 1/3 cap for primaries.
- Unfortunately, the cap may not provide sufficient flexibility for the issuer to raise much needed capital.
- An alternative for the issuer is to structure a PIPE or a 144A or other exempt offering alongside a take down off of a shelf (subject to the 1/3 cap):
- Things to consider:
  - General solicitation issues: an issuer contemplating a PIPE or other exempt offering in close proximity to a public offering should consider whether the public offering may have been a “general solicitation” that renders the offering exemption unavailable for the PIPE.

PIPE for smaller issuer *(cont'd)*

- Integration issues:
  - Offering only to QIBs and no more than two or three large institutional accredited investors (in reliance on no-action letter guidance), or
  - Offering in reliance on Section 4(a)(2) and Regulation D
    - SEC C&DI Question 139.25 (Nov. 2008) clarified that under appropriate circumstances, there can be a side-by-side private offering under Section 4(a)(2) or Rule 506 with a registered public offering.
    - C&DI focuses on how the investors in the private offering are solicited — whether by the registration statement or through some other means that would not otherwise foreclose the availability of the Section 4(a)(2) exemption, such as a pre-existing relationship with the issuer.

PIPE for selling securityholders

- A significant securityholder or group of securityholders may wish to dispose of their securities.
- These securities may be restricted securities because:
  - They were acquired in an exempt offering, or
  - The securityholders are affiliates of the issuer ("control stock")
- Why should these be structured as PIPE transactions?
  - Permits the securityholders to dispose of their securities in an organized manner without disrupting the market for the issuer's securities.
  - Helps to avoid the downward pressure on the issuer's stock price as a result of alternative means of disposing of the securities, such as:
    - Dribbling out securities over a period of weeks
    - Dumping the issuer's stock in a block trade
  - The transaction is not announced until definitive purchase agreements are signed (the issuer's stock will not suffer the downward pressure associated with an overhang).

PIPE for selling securityholders *(cont'd)*

- How is this accomplished?
- By utilizing the Section 4(a)($1^1/_2$) exemption:
  - Can be used by institutional investors to resell restricted securities purchased in a private placement.
  - Can also be used by affiliates for the sale of control securities when Rule 144 is unavailable.
- In a Section 4(a)($1^1/_2$) transaction:
  - The seller must sell in a "private" offering to an investor that satisfies the qualifications (for example, sophistication, access to information, etc.) of an investor in a Section 4(a)(2) private offering, and
  - The investor must agree to be subject to the same restrictions imposed on the seller in relation to the securities (for example, securities with a restricted legend).
- Other considerations:
  - Requires the issuer's cooperation to effect the PIPE transaction.
  - Purchase agreement contains both issuer and selling securityholder reps & warranties.

Securities Exchange Requirements—a brief overview

Nasdaq Rule 5635 Requires Shareholder Approval for Certain Types of Transactions

- Issuances that may exceed 20% of the pre-transaction total shares outstanding (“tso”) or voting power that are priced at less than market value
  - Sales by officers, directors and substantial shareholders may be aggregated with shares issued by the company
- Issuances that may result in a “change of control”
  - If a transaction results in an investor or group of affiliated investors obtaining a 20% interest, or the right to acquire such interest, in the issuer on a post-transaction basis the transaction will constitute a change of control for Nasdaq purposes
  - Notwithstanding, an exception exists for pre-existing control positions that are not displaced by the transaction
  - There are a number of ways to address the change of control issue, such as
    - Providing evidence that there are holders that have more sizable holdings and exert control
    - Ensuring that the new holder does not have special governance rights
    - Including a provision that holder will enter into a proxy so that any right to vote in excess of 19.9% will be voted with the majority

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Nasdaq Rule 5635 Requires Shareholder Approval for Certain Types of Transactions *(cont'd)*

- Issuances that may exceed 20% of the tso or voting power of the issuer if they are connected with the acquisition of stock of another company or, more generally, with the acquisition of any asset(s)
  - This applies to both above and below market issuances
- Issuances in connection with an acquisition where an officer, director or substantial shareholder has a 5% or greater interest (or such persons collectively have a 10% or greater interest) in the company or assets to be acquired or in the consideration to be paid and the issuance of stock could result in an increase in outstanding common shares or voting power of 5% or more

Shareholder Approval

- Nasdaq will consider the following factors in aggregating private placement transactions for purposes of the 20% rule:
  - Timing of the issuances;
  - Commonality of investors;
  - Existence of contingencies between the transactions;
  - Similarities between deal structures;
  - Commonalities as to use of proceeds; and
  - Timing of the board of director approvals.

Shareholder Approval *(cont'd)*

- Rule 5635(c) applies to issuances of equity securities and any security convertible into or exercisable for equity securities.
- Issuers and placement agents must be cautious of the impact of warrants.
  - Blended average test: if the common stock portion alone is less than the applicable threshold and is priced below the greater of market and book value, but the deal includes warrants that push the offering over the threshold, shareholder approval is required unless the warrants are issued at or above market and are not exercisable for at least six months (the warrants are excluded from the calculation).
  - 1/8 test: if the common stock portion alone is more than the applicable threshold, Nasdaq will attribute at least $0.125 in value to the purchase of the unit for each share purchasable by a warrant, regardless of whether the exercise price exceeds the market price.

Shareholder Approval *(cont'd)*

- Rule 5635(c) does not apply to "public offerings."
  - The definition of "public offering" is not the same as "registered offering." For example, registered directs are generally not considered public offerings by the exchanges even though they are registered with the SEC.
- An issuer may avoid triggering the 20% rule by implementing a share cap, or pricing floor.
  - The cap or floor must remain in place for the life of the security or until shareholder approval is obtained.
  - Caps cannot contain penalty provisions or "sweeteners," which are triggered on the outcome of the vote.

Use of Share Caps and Pricing Floors to avoid exceeding the Nasdaq shareholder approval thresholds

- When the terms of the securities being offered create the potential for an issuance in excess of 20%, the company may avoid the need for up-front shareholder approval by including a cap on the number of shares that can be issued or a floor on the conversion price, such that no securities may be issued in excess of 19.9% of the pre-transaction tso without shareholder approval

Interpretative Material Regarding the Use of Share Caps or Pricing Floors – Alternative Outcome Transactions

- IM 5635-2 indicates that share caps and price floors are acceptable mechanisms to avoid the need to obtain shareholder approval prior to the completion of the transaction, provided:
  - The cap or floor remains in place for the life of the security or until shareholder approval is obtained (e.g., a cap which is only in place while an issuer is listed on Nasdaq will be deemed defective)
- Any shares issued pursuant to such a cap would not be eligible to vote with the shareholders on the removal of the cap or approval of the deal or any aspect of the deal

Interpretative Material Regarding the Use of Share Caps or Pricing Floors – Alternative Outcome Transactions *(cont'd)*

- Caps may not be used in connection with the issuance of securities that include "penalty" provisions or "sweeteners" (referred to as "alternative outcome transactions"), which are triggered based upon the outcome of the shareholder vote
  - A right of redemption would constitute a penalty provision unless the proceeds are held in escrow pending the shareholder vote
- Notwithstanding, the issuance of convertible securities with "sweeteners" or "penalties" may comply with the Nasdaq rules, provided that no equity securities are issuable prior to the shareholder vote
- Following a negative vote the securities may convert into up to 19.9% or the pre-transaction tso; however, additional votes to remove the cap would not be permitted pursuant to the alternative outcome policy