



WHAT'S THE DEAL?

Private Investment in Public Equity Transactions

Here's the Deal:

- A private investment in public equity (PIPE) transaction is a private placement undertaken by an already public company.
- Typically, the investors in PIPE transactions are institutional accredited investors and qualified institutional buyers (QIBs).
- The issuer engages a placement agent to identify investors, wall cross these investors and have the investors agree to certain confidentiality undertakings and to refrain from trading in the issuer's securities for a period of time. The subscription agreement between the issuer and each of the investors include, among other things, a commitment on the issuer's part to file and have declared effective, within particular time frames, a resale registration statement.
- The resale registration statement covers the resale from time to time of the securities purchased by the investors in the PIPE transaction.
- A PIPE transaction can be completed relatively quickly and efficiently and may be the best financing alternative in a number of instances.

What's the Deal?

A PIPE transaction refers to a private placement of a public issuer's equity or equity-linked securities to investors, where a resale registration statement covering the resale from time to time by the PIPE investors of the securities purchased in the PIPE transaction is made available by the issuer.

A PIPE transaction is marketed by the issuer's placement agent to potential investors that have been wall-crossed and that have agreed to confidentiality and a trading restriction. As a result, an issuer will be able to assess whether there is interest in a transaction on terms that are attractive to the issuer and to enter into definitive purchase agreements before the issuer makes any public announcement. This is important in order to avoid investor front-running among other things.

A PIPE transaction is structured as a private placement made pursuant to the Section 4(a)(2) statutory private placement exemption under the Securities Act of 1933, as amended (the "Securities Act"), and possibly Rule 506(b) of Regulation D.

Why a PIPE Transaction?

A PIPE transaction often is simply the most cost-effective alternative for many issuers especially during periods of heightened market volatility. While incurring substantially lower transaction expenses than it would in a public offering, an issuer will also expand its base of accredited and institutional investors through the PIPE transaction.

A PIPE transaction permits an issuer to raise capital quickly. Investors receive only very streamlined offering materials or information, including publicly filed Securities Exchange Act of 1934 ("Exchange Act") reports, unless there is a new, recent development or other material nonpublic information (MNPI).

As noted above, a PIPE transaction will be disclosed to the public only after definitive purchase commitments are received from investors and generally will close and fund within two to five days of receiving definitive purchase commitments. In a PIPE transaction, investors may expect a discount to the current market price to reflect the liquidity discount since initially investors receive "restricted securities" and will not have access to the resale registration statement for some period of time.

Comparing a PIPE Transaction with Other Financing Alternatives

In comparing a PIPE transaction against other potential financing options, an issuer should generally consider that:

- It is the investor, not the issuer, that bears the market risk,
- Sophisticated institutional investors are familiar, and the U.S. Securities and Exchange Commission (SEC) is comfortable, with the PIPE format,
- PIPEs typically involve a modest discount to market price,
- PIPEs do not have any of the negative effects often associated with a "death spiral" offering or an equity line of credit,
- Unless the PIPE is executed in connection with an acquisition or in a distressed environment, generally PIPE investors will not expect to have any ongoing affirmative covenants,
- Representations and warranties expected from the issuer will be quite consistent with those given by an issuer in its underwritten public offerings, and
- PIPE investors generally will not ask to and will not want to receive any MNPI (other than the mere fact that the issuer is contemplating a financing).

PIPE transactions may have some disadvantages, such as:

- The discount to the market price that the investors would require in order to compensate for the initial resale restrictions,
- The transaction may only be marketed to accredited investors,
- Certain investors will not agree to be wall-crossed,
- The issuer's inability to sell more than 20% of its outstanding stock at a discount without receiving prior stockholder approval, and
- A limit on the issuer's number of "blackout" (or suspension) periods while the resale registration statement is effective.

Participants in PIPE Transactions

Companies that are public reporting companies may consider a PIPE transaction.

The universe of potential investors is limited to accredited investors. Accredited investors include hedge funds, mutual funds, pension funds, sector and institutional buyers, venture funds and private equity firms. Distressed funds and venture funds have also begun participating in PIPE transactions.

There is no limit on the number of offerees in a PIPE transaction, so long as the placement agent is not engaging in any marketing or sales activity that would constitute a general solicitation.

The issuer will engage a placement agent to assist usually on an exclusive basis in identifying potential investors. The placement agent will play an essential role in wall crossing potential investors and ensuring that the investors agree to confidentiality undertakings before the name of the issuer is shared. The potential investors also will be required to agree to refrain from trading in the issuer's securities for a specified period of time.

Offering Materials

In a PIPE transaction, investors may receive a private placement memorandum; however, in many instances, the private placement memorandum will be quite limited and may contain principally the issuer's Exchange Act documents. Investors generally will not receive other MNPI.

Securities Offered in PIPE Transactions

In a typical PIPE transaction, investors enter into a purchase agreement that irrevocably commits them to purchase a fixed number of securities at a fixed price, not subject to market price or fluctuating ratios. Securities sold in a PIPE transaction are usually common stock, convertible preferred stock, convertible debentures, warrants, or other equity or equity-linked securities. Most PIPE transactions involve the sale of common stock at a fixed price, often with warrants.

Negotiation Points in PIPE Transactions

The price is set through discussions between the placement agent and the issuer, just as it is during the course of an underwritten (firm commitment) offering.

The price risk in a fixed priced transaction is borne by the purchaser during the period from execution of the purchase agreement until the closing.

The purchase agreement will contain a detailed set of issuer representations and warranties. These will cover matters relating to the authorization of the transaction and the issuance of the securities, the issuer's business and operations, the issuer's Exchange Act reports, the issuer's compliance with laws, non-contravention representations and related matters. The issuer's representations may be negotiated with potential investors.

The purchase agreement will contain representations and warranties from the investor generally relating to the investor's authority to enter into the transaction documents, the status of the investors, the sophistication of the investors, the reliance on the part of the investor's on their own diligence and on the issuer's Exchange Act filings, and related matters. The investor also will be asked to reaffirm its

confidentiality undertaking and its covenant not to trade in the issuer's securities until the transaction is publicly disclosed and any other MNPI shared with the investor is disclosed.

The purchase agreement will contain numerous covenants on the issuer's part, including the covenant to file a resale registration statement. Investors will negotiate the time period for the initial filing of the resale registration statement and the time period for addressing any comments from the SEC to declare effective the resale registration statement. The investor will negotiate penalty payments for failure to meet any of the specified milestones. In addition, the investor also will negotiate limitations on the number of blackout periods and the length of such periods, as well as the period during which the resale registration statement must be kept effective. Finally, the investor may negotiate specific time periods in which the issuer will deliver an opinion to its transfer agent following the effectiveness of the resale registration statement to lift the restricted legend when the PIPE investor resells the securities.

The conditions to closing will not include any conditions that are within the purchaser's control. The issuer will be required to cause its counsel to deliver a legal opinion to the investors at closing.

Depending on the terms of the engagement letter between the issuer and the placement agent, the issuer may have other commitments to the placement agent, which may include a requirement to cause its counsel to deliver a reliance letter relating to the investor legal opinion.

The Resale Registration Statement

In connection with a PIPE transaction, an issuer typically must keep a resale registration statement effective for an agreed-upon period of time so that the securities may be sold freely, without reliance on Rule 144, by the PIPE investors. During this period, the issuer may suspend the use of the resale registration statement to amend it or to remedy a material misstatement or omission. This suspension is often referred to as a "blackout" period. During a blackout period, PIPE purchasers will have limited liquidity, as they will not be able to rely on the resale registration statement to sell the securities purchased in the PIPE transaction. Investors will negotiate a limit on the length and number of blackout periods.

If an issuer has a shelf registration statement on file, it is generally a primary shelf registration statement covering the sale by the issuer of its newly issued securities. The issuer must 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.

The issuer does not need to be eligible to use a registration statement on Form S-3 ("Form S-3") on a primary basis in order to complete a PIPE transaction, but must be eligible to use Form S-3 on a resale basis.

The 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. Nevertheless, an issuer should consider using a Form S-3, since it is more cost-effective and less time consuming than using a Form S-1 and is less burdensome and may be updated by the periodic filing of Exchange Act reports without the need to file post-effective amendments.

In order to use the Form S-3 for resales (secondary shares), an issuer must (1)(i) be organized and have its principal business operations in the United States or one of its territories; (ii) have a class of securities

registered pursuant to Section 12(b) of the Exchange Act or a class of equity securities registered pursuant to Section 12(g) of the Exchange Act or be required to file reports pursuant to Section 15(d) of the Exchange Act; and (iii) have been public and have timely filed all required filings for a period of at least 12 calendar months immediately preceding the filing of the Form S-3 and have filed all required reports in a timely manner; and (2) the issuer and its consolidated and un-consolidated subsidiaries must not, since the end of the last fiscal year for which certified financial statements of the issuer and its consolidated subsidiaries were included in an Exchange Act report, (i) have failed to make any required dividend or sinking fund payment on preferred stock or (ii) defaulted on the terms of any borrowing or on any long-term lease, which defaults in the aggregate are material to the financial position of the issuer and its consolidated and unconsolidated subsidiaries, taken as a whole.

Regulatory Approvals

A PIPE transaction does not require any prior approvals from regulatory agencies or self-regulatory organizations if the issuer does not issue more than 20% of its pre-transaction total shares outstanding at a discount and if the transaction does not represent a change of control or otherwise trigger approval requirements.

The issuer and its counsel should consider carefully the applicable securities exchange rules. The issuer should consider not only the effect of completing the proposed PIPE transaction, but also, if the issuer has completed other private transactions within the same six-month period, the aggregate effect of such transactions, all of which may be aggregated by the exchange.

The New York Stock Exchange (NYSE), the NYSE American and Nasdaq have similar requirements, which we summarize briefly below, but which require a close look:

- Rule 312.03(c) of the NYSE Listed Company Manual requires that the issuer obtains shareholder approval prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if the common stock has, or will have upon issuance, voting power equal to, or in excess of, 20% of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock. Shareholder approval is not required under this rule if the common stock is sold in (a) any public offering for cash or (b) any other financing in which the company is selling securities for cash involving a sale of (i) common stock at a price at least the "minimum price" or (ii) securities convertible into or, exercisable for common stock if the conversion or exercise price is at least the "minimum price." "Minimum price" is defined as the lower of (i) the closing price of the issuer's common stock immediately before the execution of the transaction agreement and (ii) the average closing price of the issuer's common stock during the five days immediately preceding the transaction agreement.
- Section 713 of the NYSE American Company Guide requires that an issuer obtain shareholder approval for a transaction involving (1) the sale, issuance or potential issuance by the company of common stock (or securities convertible into common stock) at a "minimum price" which, together with sales by officers, directors or principal shareholders of the company, equals 20% or more of presently outstanding common stock or (2) the sale, issuance or potential issuance by the company of common stock (or securities convertible into common stock) equal to 20% or more of

presently outstanding stock for a “minimum price.” “Minimum price” is defined as the lower of (i) the closing price of the issuer’s common stock immediately before the execution of the transaction agreement and (ii) the average closing price of the issuer’s common stock during the five days immediately preceding the transaction agreement.

- Rule 5635 of the Nasdaq Listing Rules requires that an issuer obtain shareholder approval in connection with a transaction other than a public offering, involving the sale, issuance or potential issuance at a “minimum price” by the issuer of common stock (or securities convertible into or exercisable for common stock), which alone or together with sales by officers, directors or substantial shareholders of the issuer, equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance. Rule 5635(d)(1)(A) defines “minimum price” as a price that is the lower of (i) the closing price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock (as reflected on Nasdaq.com) for the five trading days immediately preceding the signing of the binding agreement.

Shareholder approval also may be required by the rules of the securities exchanges for a private placement completed in connection with an acquisition, a private placement that results in a change of control or a private placement involving related parties.

Traditional PIPE Transaction Compared to PIPE with Trailing Resale Registration Rights

While the PIPE format began with the so-called “traditional” PIPE transaction structure, which we describe below, most of the PIPE transactions that have been completed in recent years have taken the form of PIPE transactions with trailing resale registration statements.

A traditional PIPE transaction is a private placement of either newly issued shares of common stock or shares of common stock held by selling stockholders (or a combination of primary and secondary shares) of an already public company that is made through a placement agent to accredited investors wherein definitive purchase agreements are executed, the transaction is announced and the closing takes place only once the resale registration statement is to be declared effective by the SEC. Key differences are summarized on the next page.

Differences	Traditional PIPE Transactions	PIPE Transaction With Trailing Registration Rights
Structure	Through a definitive purchase agreement between the investors and the issuer in which the investors commit to purchase securities at a fixed price and the funding is conditioned on the availability of the resale registration statement.	Closing takes place promptly after entry into a definitive purchase agreement. The issuer has a post-closing obligation to file a resale registration statement and use its best efforts to have it declared effective.
Has control of the process	Placement agent. The placement agent conducts its own business and financial due diligence. Traditional PIPE purchasers generally do not negotiate for themselves ongoing negative covenants or covenants relating to information rights or corporate governance.	Placement agent or lead investor. Investors may limit their diligence to public filings.
Closing conditions (in general)	The issuer must update the representations and warranties made in the purchase agreement (which are similar to those contained in an underwriting agreement) and deliver a comfort letter and legal opinions (including a 10b-5 negative assurance relating to the private placement memorandum and the resale registration statement) to the placement agent; There can be no material adverse change since execution of the purchase agreement; and The SEC must have stated its willingness to declare the resale registration statement effective (which consequently makes available to investors a resale registration statement at the time of closing).	The purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement), which will be brought down at closing. For resettable or variable deals, the purchase agreement also may contain covenants requiring the future issuance of additional securities by the issuer at no cost to the purchaser. The purchase agreement may, depending on the nature of the purchaser, 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 the purchaser). The issuer must deliver a comfort letter and legal opinions to the placement agent. Each investor must deliver to the issuer and the issuer’s transfer agent a certificate as to the investor’s compliance with the prospectus delivery requirements in order to obtain unlegended stock certificates in the future; and There can be no material adverse change since execution of the purchase agreement.
Mode of settlement	Outside of the Depository Trust Company (DTC) system.	Outside of the DTC system.

Other Legal Concerns in PIPE Transactions

REGULATION FD

The agents in a PIPE transaction (*e.g.*, the placement agent, accountants and other participants in the PIPE process) owe a duty of trust or confidence to the issuer. Inasmuch as the issuer does not share any information with potential investors that has not already been included in its Exchange Act reports, the fact that the issuer is contemplating a PIPE transaction may oftentimes by itself constitute MNPI and the issuer will not want to be forced to make a premature disclosure regarding a financing. Hence, in compliance with Regulation FD, the issuer should ensure that, before the placement agent reveals the issuer's name, the placement agent obtains an oral or written agreement from each potential purchaser it contacts that information shared will be kept confidential and that the agreement contains an explicit undertaking to refrain from trading in the issuer's stock. Considering that the issuer's contemplation of a PIPE transaction generally seeks to preserve its flexibility and only make a disclosure once definitive agreements have been executed, it is unlikely that an issuer will want to engage in any form of general solicitation, even if permissible.

REGULATION M

Since most PIPE transactions are considered "distributions" for Regulation M purposes, the placement agent participating in a PIPE transaction must file a Regulation M notice with FINRA and refrain from making a market in the issuer's securities during the applicable Regulation M "restricted period," which is either one or five days prior to the pricing (as opposed to the funding or closing of the transaction) depending on the average daily trading volume of the issuer's security.

SEC COMMENTS

The SEC Staff has issued comments to certain issuers (usually small cap issuers and issuers that have sold shares in excess of 33% of the total shares outstanding prior to the PIPE transaction, which is considered as "disproportionately large") that have filed resale registration statements to cover the resale of shares originally offered in a PIPE transaction, questioning the appropriateness to use a resale registration statement (rather than a primary registration statement) for those shares, especially for PIPE transactions involving convertible securities.

In these cases, the SEC will use the factors it outlined in its 1997 interpretative guidance and evaluate the facts and circumstances of the issuance and the resale registration statement by assessing (i) the amount of securities involved, (ii) how long the securities have been held, (iii) whether the investors are at market risk from the time they purchase the securities, (iv) the circumstances under which the securities were acquired, and (v) whether it appears the seller is acting as a conduit for the issuer. If the SEC finds that the private placement was properly completed, the issuer can proceed with the use of the resale registration statement. If the SEC disallows the resale registration statement to proceed, the issuer can cut back on the number of shares and then file a second resale registration statement for the shares that were cut back.

Transactions Not To Be Confused with PIPE Transactions

The following transactions are not to be confused with PIPE transactions:

- **Death spiral or toxic convert.** "Death spiral" or "toxic convert" refers to a privately placed convertible security that has a floating conversion ratio but without a floor. The conversion ratio of the security adjusts based upon the market price of the issuer's securities at some point in the future, usually at the time of conversion. Death spirals or toxic converts typically reset or adjust downward (to protect the investor) and not upward (to protect the company). Death spirals or toxic converts typically are priced at some discount to the company's closing bid price over a period of days preceding the pricing date. This price can be manipulated easily.
- **Equity line of credit.** Under an equity line of credit, the issuer enters into a purchase agreement with an investor pursuant to which the company has the right, during the term of the equity line and subject to certain conditions, to put its securities to the investor. Some equity lines of credit are completed using a shelf registration statement and others are completed as private placements with an obligation to register the resale of the securities sold under the equity line. Unlike PIPEs, these transactions can also result in ongoing and substantial dilution.
- **Registered direct transaction.** A registered direct offering is a public offering but some of its features are akin to a private placement (*i.e.*, sales to selected institutional investors by a placement agent). The offered securities in a registered direct transaction are sold pursuant to an effective registration statement. Investors receive a preliminary prospectus (or red herring) during the marketing phase and a final prospectus prior to closing. The offering closes through DTC and investors receive their shares through DTC rather than receiving physical certificates like they would in a PIPE transaction.

Checklist of Key Questions

- ✓ Are the issuer's Exchange Act filings current?
- ✓ What information will be shared with investors other than the mere fact that the issuer is considering a financing through a PIPE transaction?
- ✓ When will such information be cleansed, or will investors remain restricted from trading for a period of time?
- ✓ Will the issuer use any information other than its Exchange Act filings?
- ✓ Does the placement agent have appropriate information walls and training in place for personnel participating in PIPE transactions?
- ✓ Does the placement agent use a wall crossing script or an NDA?
- ✓ Will the transaction be structured as an at-market deal?
- ✓ What securities will be offered in the PIPE transaction? If there are warrants or convertible securities, have the parties considered the securities exchange rules?
- ✓ Has the issuer and its counsel had a discussion with the securities exchange?
- ✓ Has the issuer considered the time required to file a resale registration statement?
- ✓ Any concerns regarding a review by the SEC?
- ✓ Are there any concerns regarding the amount of securities that will be included in the resale registration statement?
- ✓ Has the issuer filed its supplemental listing application?
- ✓ Does the purchase agreement provide for any covenants that limit the company's activities?