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PERSPECTIVE

PIPEs: Optionality in volatile markets

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A PIPE, or private investment in public equity, is a private placement transaction executed in accordance with the Section 4(a)(2) exemption and Rule 506(b) of Regulation D. Investors are granted securities in a public company coupled with registration rights that will provide them with resale capability in the open market. PIPEs are a popular option for companies as they allow a company to access capital sources more quickly and no public disclosure is typically made until after investors have committed to participate in the transaction. This makes PIPEs a popular choice during times when the public capital markets are volatile and where pricing may be risky or uncertain. PIPEs have provided many companies over the years with a strong source of liquidity. From January through May of 2020, it is estimated that almost $30 billion has been raised from PIPE transactions.

PIPE Structures

The most common PIPE transaction is typically conducted through a placement agent and generally involves all investors executing a securities purchase agreement and a registration rights agreement. Both documents are generally standard forms that are signed by all participating investors and provide for the purchase of a fixed number of securities at a fixed price. The registration rights agreement mandates the company to file a resale registration statement within a specified time period. This filing is what provides the investors with the resale liquidity to sell their restricted securities acquired in the PIPE. Some PIPEs will be closed and funded prior to the filing of the resale registration statement while others will fund into escrow with such funds being released only upon effectiveness. For those that fund prior to achieving effectiveness, the registration rights agreement generally includes a specified time period in which the S-1 or S-3 must be filed and a time by which effectiveness must be obtained. If the company fails to meet the timing target, there are typically penalties assessed against the company and paid to the investors.

PIPEs can also take a more specialized path where a lead investor assumes responsibility for negotiating the form of purchase agreement. In this alternative PIPE structure, there is typically no placement agent. This type of PIPE will involve a significant amount of negotiation on the purchase agreement. Unlike the more standard PIPE structure discussed above, a lead investor may negotiate several additional provisions for inclusion in the purchase agreement. This can include such requests as board seats, anti-dilution protection, preemptive rights and consent rights. All of these rights are in addition to the standard registration rights which are always granted in a PIPE.

For investors, while they may be trading some loss of flexibility in terms of resale capability, a PIPE often means a larger discount to the current market price of a company than can be achieved in the context of a traditional public offering. What structural option to choose is generally a function of investor interest and the need for the services of a placement agent in order to execute a PIPE.

PIPE Execution

Regardless of what structuring option a company decides to use in connection with their PIPE, there are a few important considerations to keep in mind to ensure smooth execution.

The first is shareholder approval. If the number of shares to be issued in the PIPE equals 20% or more of the total number of shares outstanding before the offering (or 20% or more of the voting power) and is being sold at a discount, then shareholder approval is typically required. Companies must also consider any other private transactions completed during the six-month period prior to the contemplated PIPE when calculating the 20% threshold.

The second consideration is diligence and confidentiality. Investors in a PIPE will often want to perform their own diligence on a company, especially if a placement agent is not being used for the transaction. A company generally should not provide investors with any information that does not already appear in its public filings but even the knowledge of the impending PIPE creates material non-public information concerns. As a result, all investors participating in the PIPE process should sign or agree to some form of confidentiality restriction and should agree to refrain from trading the company's stock for a certain period of time to avoid securities violations.

Finally, in determining the time period required for filing the resale registration statement, a company should be mindful of whether they are eligible to file an S-3 or if they will be required to use an S-1 instead. If a company must use an S-1, there will obviously be timing implications with respect to effectiveness as it generally takes longer for the SEC to review and provide comments on an S-1.

PIPE Documentation

The PIPE transaction structure does provide a level of simplicity from a documentation perspective. A PIPE will always have a form of purchase agreement and generally a separate registration rights agreement. The purchase agreement will include a set of typical closing conditions, including delivery of closing certificates, legal opinions, etc. If a placement agent is being used, an investor presentation or other private placement memorandum is prepared for marketing purposes and a comfort letter may be requested. Finally, the company will be required to prepare the resale registration statement.

To the extent possible and depending upon the timing of the PIPE, it is a good idea to begin preparation of the registration statement while the transaction is being negotiated and closed so a company can be prepared to file immediately following the closing. Given the specified deadlines for effectiveness that are often included, it is critical that companies do not wait until the last minute to file especially if they are required to use an S-1 as the amount of time necessary to clear with the SEC can vary.

PIPEs: Options Are Always Helpful

PIPEs can be very advantageous to both companies and investors and provide much needed capital in a relatively short execution window. This can be important in times of extreme volatility. Especially in a time of uncertainty and volatility like we are living in now with COVID-19 and an upcoming election, executing a public offering can be an increasingly tricky proposition. Finding an ideal market window can be very difficult and it is a time when many companies are seeking additional capital to ensure continued growth and momentum in their business. PIPEs provide companies with an option to access such capital and the added advantage of not being publicly announced until a company is certain they are successful which limits the risk of failure in the context of a public offering. ■

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