

Understanding the Steps for Conducting a PIPE

Law360, New York (September 12, 2013, 3:17 PM ET) -- The advantage of raising money through a private investment in public equity (PIPE) transaction is the relative speed with which PIPE transactions can be completed. Given that the securities being purchased do not need to be registered, once terms have been agreed to, a transaction can be completed, if necessary, from start to finish virtually overnight.

Prior to commencing any discussions with respect to the identity of the issuer or the terms of the deal, many PIPE transactions begin with a nondisclosure agreement between a lead investor and the issuer or the placement agent.

Alternatively, in the interest of time and expense, the parties may confirm an agreement to keep the information regarding the transactions and any diligence materials confidential through an email acknowledgment or, in the case of a placement agent and an investor that have worked together on prior deals, by virtue of a standing confidentiality agreement between the placement agent and the investor, or simply by a common understanding as a result of past practice.

These discussions typically result in a term sheet summarizing the major business terms. A lead investor will negotiate terms either through a placement agent acting on behalf of the issuer or directly with the issuer if there is no placement agent in the deal. In many cases, the placement agent and the issuer will structure the transaction and finalize terms before presenting it to investors.

After the term sheet is finalized, the next step is drafting and negotiating the definitive documents. Usually this is also done between the issuer and its counsel and a lead investor and its counsel. Other smaller investors may get the opportunity to comment on the documents depending on their leverage in the deal.

However, it is increasingly more common, particularly in transactions where the issuer is issuing common stock only or common stock together with warrants, and in transactions where there is no real "lead" investor for the placement agent and its counsel to prepare the transaction documents directly with the issuer.

Depending on the deal structure, the definitive documents typically include a securities purchase agreement, a registration rights agreement, a form of convertible note or an indenture, a certificate of designations setting forth the rights and preferences of convertible preferred stock and/or warrants to purchase common stock of the issuer.

In a typical PIPE transaction, the securities purchase agreement will contain standard buyer representations, including private-placement representations and a fulsome set of issuer

representations covering the ability of the issuer to enter into the applicable transaction, the availability of an exemption from registration, a 10b-5 representation on the issuer's public filings and any other information provided to the buyer, and various other representations covering the issuer's business.

As part of the preparation for signing and closing, the issuer and its counsel will have to work together to complete any schedules to the issuer's representations set forth in the securities purchase agreement.

In the interest of time, disclosure schedules can sometimes be avoided by making reference to the issuer's public filings in place of a schedule of exceptions. However, the investors will prefer to get disclosure schedules in order to make certain that they understand exactly what the issuer is excluding from its representations.

A PIPE transaction can be structured so that signing and closing occur simultaneously, or the closing can occur some time after signing if, for example, the issuer is required to obtain an approval or waiver that will not be obtained until after signing or other relevant facts make such a structure desirable.

From an investor perspective, a simultaneous signing and closing is preferable in order to avoid being exposed to any negative developments with respect to the issuer or the markets that may occur between signing and closing. Then again, where closing will have to be delayed, the parties may desire to sign prior to closing in order to lock in pricing.

Prior to closing, the issuer will have to file a listing application or notification with the applicable exchange or market and may have to receive approval of the applicable exchange or market. The board of directors of the issuer must also adopt the resolutions approving the deal and a pricing committee may have to adopt resolutions to approve the pricing.

Other than the payment of the purchase price and executing documents, the investors do not typically have to make any deliveries to the issuer at closing. If the signing and closing will not be simultaneous, it will be a condition to closing that each investor's representations in the purchase agreement are true and correct as of the closing.

In addition to the need to deliver the securities at closing (whether it be common stock, convertible notes, warrants, convertible preferred stock or any combination thereof), the issuer will typically have to deliver certain additional closing items to the investors. Often a legal opinion of the issuer's counsel addressed to the investors is delivered.

The opinions issued typically include due incorporation of the issuer and its subsidiaries, due execution and authorization to enter into the transaction documents, no conflicts with or defaults under any of the issuer's material contracts, organizational documents or applicable law, due authorization and valid issuance of the securities, and an opinion stating that an exemption from the registration requirements of the Securities Act of 1933, as amended, is available for the offering.

Other typical closing deliverables include good-standing certificates of the issuer and its subsidiaries and officer's and secretary's certificates certifying as to the accuracy of the issuer's representations and satisfaction of the issuers' obligations contained in the purchase agreement and the issuer's constituent documents, respectively.

There may be consents and/or waivers of third parties that must be obtained at or prior to closing. These can include senior lenders or existing investors in the issuer who, under previous investment agreements, may have restricted the issuer from issuing additional securities, or obtained rights of participation in or anti-dilution rights with respect to future securities issuances by the issuer that will be exercised or waived by the existing investors.

The stock exchange on which the issuer's common stock trades may, in certain circumstances, require the approval of the issuer's stockholders to issue all of the shares contemplated in the PIPE transaction. PIPE investors who want comfort that the stockholder approval, where required, will be obtained, may require as a condition to closing that certain stockholders of the issuer enter into voting agreements to commit to vote to approve the transaction.

Investors may require the issuer to negotiate lock-up agreements with the issuer's executive officers, directors and/or significant stockholders contractually prohibiting them, during a negotiated period of time, from selling the issuer's equity or equity-linked securities.

As a condition to closing a PIPE transaction, investors can require that an issuer deliver standing instructions to the issuer's transfer agent with respect to the issuance of shares of common stock upon conversion or exercise of the securities issued in the transaction. Such instructions may also cover the removal of restrictive legends or the issuance of legend-free shares upon conversion or exchange following registration or the availability of an exemption from registration.

Finally, the transaction must be announced in order for the investors to be cleansed of material nonpublic information and for the issuer to comply with the current report on Form 8-K rules. The transaction will require disclosure under Item 3.02, Unregistered Sale of Equity Securities (in the case of a "standard" or "nontraditional" PIPE), but may also require disclosure under other items, such as Item 2.03, Creation of a Direct Financial Obligation, or an Obligation Under an Off-Balance Sheet Arrangement of a Registrant.

Typically a press release is filed before the markets open for trading on the first trading day after signing. The current report on Form 8-K is often filed at the same time as the press release announcing the deal, but may be filed up to four business days following the signing and will typically include the transaction documents as exhibits.

There are also post-closing matters that need to be complied with. Within 10 days after closing, the issuer is required to file any applicable Form D with the U.S. Securities and Exchange Commission. Depending on an investor's ownership in the issuer following closing, the investor may have certain post-closing filing requirements, such as the requirement under Section 13 (15 USCS § 78m) of the Securities Exchange Act of 1934, as amended (the Exchange Act) to file a Schedule 13G (17 CFR 240.13d-102) or Schedule 13D (17 CFR 240.13d-101) if its beneficial ownership exceeds 5 percent of the outstanding shares of the issuer, and a Form 3 or 4, as required by Section 16 (15 USCS § 78p) of the Exchange Act, if its beneficial ownership exceeds 10 percent of the outstanding shares of the issuer.

If the transaction includes resale registration rights, the issuer will have an obligation to file a resale registration statement registering the shares issued in, or the shares underlying the securities issued in, the PIPE transaction.

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