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ALERTS

PIPEs and Registered Directs: COVID-19 and Alternative Financing Transactions

April 7, 2020

- A Source of Capital and Investment Opportunity in Stressed Markets
- Speed of Capital
- Few Execution Hurdles
- Advantageous Deal Terms

Among the myriad issues raised by the COVID-19 pandemic is the need for alternative sources of financing for public companies. Private Investment in Public Equity ("PIPE") and related transaction structures are a prime way to provide this capital. Hedge and other investment funds are adept in PIPEs and are well positioned to invest.

These transactions can be done quickly, even overnight. In a PIPE transaction, investors purchase equity or equity linked securities, such as common stock, convertible preferred stock, convertible notes and warrants, directly from the issuer. The securities can be sold pursuant to an exemption from registration under the Securities Act of 1933 (a PIPE) or off a shelf registration statement (commonly referred to as a "Registered Direct" transaction).

PIPEs. PIPEs issue restricted securities requiring a subsequent resale registration statement, exemption or holding period to be resold. PIPE investors typically receive a discount to compensate for the illiquidity, although many PIPEs are actually priced at a premium to market. Attractively, an issuer facing public reporting issues, perhaps due to the impact of COVID-19 on their financial reporting, can still conduct a PIPE issuance because of the private nature of the transaction.

Registered Direct Transactions. In Registered Direct transactions, securities are issued off an effective shelf registration statement. These securities can be resold by investors immediately without any subsequent registration, commonly leading to tighter pricing. Issuers with an existing, effective shelf registration statement have already gone through the SEC comment process prior to effectiveness and can issue the securities instantaneously. Well-known seasoned issuers, or WKSIs, can file new registration statements which are effective immediately so they can conduct this type of offering also on the spot. Any issuer looking to conduct a Registered Direct offering will need to be current in its SEC reporting obligations.

Structuring Issues. Investors should keep these key issues in mind when structuring or analyzing these types of deals:

- *Capital Structure.* Consider where you want to be in the capital structure (common equity, preferred equity or debt — senior and/or secured) and whether that will be achievable under the issuer's existing debt documents and/or the terms of existing senior securities.

- *Protective Provisions*. Consider board seats or other control rights in order to get comfortable with the risk profile. In structured deals, consider protective provisions such as collateral, event of default redemptions, restrictive covenants and put rights.

- *Exchange Rules.* Issuers listed on the NYSE or Nasdaq have to comply with the listing rules of the applicable exchange.

- *Deal Size*. Both Nasdaq and the NYSE rules generally require that issuers obtain shareholder approval prior to certain issuances of 20% or more of their stock as well as issuances which result in a "change of control" under the exchange rules. In addition, NYSE rules can limit the amount an issuer can issue to a "substantial security holder." These rules can be complex, but can, in most cases, be dealt with through careful structuring and effective April 6, 2020 until June 30, 2020, the NYSE shareholder approval requirements for issuances of 20% or more and issuances to "substantial security holders" have been partially waived in response to the market and general economic disruption caused by COVID-19. Also, an issuer may be able to rely on a "financial hardship exemption" to the shareholder approval requirements if a delay in obtaining shareholder approval would "seriously jeopardize the financial viability" of the issuer. Some issuers may meet this standard due to the impact of the COVID-19 outbreak.

- *Board Seats*. Investors seeking board appointment rights should be aware that these rights may need to comply with the proportionate voting rules of the stock exchanges.

- *SEC Beneficial Ownership Rules*. Investors should be cognizant of the SEC's beneficial ownership reporting requirements and other implications under Section 13 and Section 16 of the Securities Exchange Act of 1934. These rules apply to greater than 5% and 10% beneficial owners, respectively. Investors looking to stay below these thresholds may be able to do so by structuring appropriately.

- *Registration, Resale and Liquidity*. Investors in PIPE transactions can negotiate to have their shares registered after the deal is completed. Once that registration is effective and current, the PIPE securities can be freely sold into the market. Some investors choose to forego registration and rely on exemptions from registration, such as Rule 144, to resell their securities. Rule 144 requires a minimum six-month holding period and requires that the issuer is current in its public filings until a 12-month holding period is completed (or indefinitely if the issuer was ever a shell company or for affiliates of the issuer). An issuer's ability to file a registration statement and/or remain current in its public filings will impact an investor's liquidity and it may be necessary to include deal terms to account for this risk, such as liquidated damages, events of default, put rights and collateral.

Investors well positioned to participate in these types of alternative financing transactions will undoubtedly find attractive investment opportunities in today's unprecedented environment.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

This is a fast-moving topic and the information contained in this Alert is current as of the date it was published.

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