FREQUENTLY ASKED QUESTIONS ABOUT PIPES

General Questions about PIPEs

What are PIPEs?

A PIPE (Private Investment in Public Equity) refers to any private placement of securities of an already-public company that is made to selected accredited investors (usually to selected institutional accredited investors) wherein investors enter into a purchase agreement committing them to purchase securities and, usually, requiring the issuer to file a resale registration statement covering the resale from time to time of the securities the investors purchased in the private placement. Equity lines of credit, as described below, are not PIPE transactions.

What kinds of securities are sold in PIPE transactions?

PIPE transactions may involve the sale of common stock, convertible preferred stock, convertible debentures, warrants, or other equity or equity-like securities of an already-public company.

What are some of the common varieties of PIPE transactions?

There are a number of common PIPE transactions, including:

- the sale of common stock at a fixed price;
- the sale of common stock at a fixed price, together with fixed price warrants;
- the sale of common stock at a fixed price, together with resettable or variable priced warrants;
- the sale of common stock at a variable price;
- the sale of convertible preferred stock or convertible debt; and
- a venture-style private placement for an already-public company.

What are some of the advantage of a PIPE transaction?

A PIPE transaction offers several significant advantages for an issuer, including:

- lowering transaction expenses;
- expanding institutional and accredited investor holdings;
- for fixed price transactions, reducing the incentive for investors to hedge their commitment by shorting the issuer's stock;
- requiring disclosure of the transaction to the public only after definitive purchase commitments are received from investors;
- requiring preparation by the investor only of very streamlined information, including publicly filed Exchange Act reports; and
- enabling a transaction to close and fund within seven to ten days of receiving definitive purchase commitments.

Traditional PIPE Transactions

What is a traditional PIPE transaction?

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.

Investors in a traditional PIPE transaction commit to purchase a specified number of shares at a fixed price, with the closing conditioned upon, among other things, the SEC's preparedness to declare effective a resale registration statement covering the resale from time to time of the shares sold in the private placement.

What is a "black-out" period?

In connection with a PIPE transaction, an issuer typically must keep effective a resale registration statement for two years. During this two-year period, the issuer may suspend the use of a registration statement because the registration statement must be amended or corrected to remedy a material misstatement or omission. This suspension period often is referred to as a black-out period. During the black-out period, the PIPE purchasers will have limited liquidity, as they will not be able to avail themselves of the resale registration statement to resell the securities purchased in the PIPE transaction.

How do traditional PIPE transactions differ from non-traditional PIPE transactions?

In a traditional PIPE transaction, the investor bears the price risk from the time of pricing until the time of closing. The issuer is not obligated to deliver additional securities to the PIPE investors in the event of fluctuations in stock price or otherwise. Investors enter into a definitive purchase agreement with the company in which they commit to purchase securities at a fixed purchase price. Investors do not fund at the time of entering into the purchase agreement. Instead, the company then files a resale registration statement covering the resale from time to time of those securities by the PIPE investors. The transaction closes once the SEC has indicated its preparedness to declare effective the resale registration statement. Consequently, the traditional PIPE investors have available a resale registration statement at the time of closing.

Non-traditional PIPE transactions generally are structured as private placements with follow-on (or trailing) registration rights. This means that once investors enter into a definitive purchase agreement, a closing is scheduled. Investors fund and the transaction closes. Post-closing, the company has an obligation to file a resale registration statement and use its best efforts to have it declared effective. Typically, the purchase agreement or a separate registration rights agreement outlines specific deadlines for the company to file, and then to seek effectiveness of, the resale registration statement. Some PIPE transactions provide for the company to make penalty payments if the company fails to meet the deadlines set for filing or effectiveness of the resale registration statement. In the case of a PIPE structured as a private placement with follow-on registration rights, the investor will not have the benefit of a registration statement for some time, usually 60 to 90 days following the closing. As a result, investors will hold restricted securities for some period of time.

What are the standard terms of a traditional PIPE?

- private placement to selected accredited investors;
- investors irrevocably commit to purchase a fixed number of securities at a fixed price, not subject to market price adjustments or to fluctuating ratios;
- purchase agreements generally contain a limitation on black-out periods;
- immediately following execution of purchase agreements with investors, the issuer files a resale registration statement covering resales from time to time of the restricted securities sold in the transaction;
- closing of the PIPE transaction occurs promptly upon notice of SEC's willingness to declare effective the resale registration statement;
- purchasers are named as "Selling Stockholders" in the resale registration statement; and
- resale registration statement kept effective until shares may be sold under Rule 144(k).

Does the placement agent or a lead investor control the process in a traditional PIPE transaction?

In a traditional PIPE transaction, the process is controlled by the placement agent, rather than by a lead investor. The placement agent conducts its own business and financial due diligence. Investors generally limit their diligence investigation to discussions with management and the company's independent auditors. Traditional PIPE purchasers generally do not negotiate for themselves ongoing negative covenants or covenants relating to information rights or corporate governance.

When does the PIPE purchaser in a traditional PIPE pay for the securities?

No money is exchanged when the purchase agreement is executed. Purchasers pay the purchase price only when the purchasers are informed that the resale registration statement is ready to be declared effective.

What are the other closing conditions for a traditional PIPE transaction?

- purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement) that must be brought down at closing;
- delivery of a comfort letter and legal opinions (including a 10b-5 negative assurance relating to the Private Placement Memorandum and to the resale registration statement) to placement agent;
- before an investor obtains unlegended stock certificates, delivery by the investor to the issuer and the issuer's transfer agent of a certificate as to the investor's compliance with the prospectus delivery requirement; and
- closing conditions limited to (1) no occurrence of any material adverse change between execution and closing, and (2) the SEC's willingness to declare effective the resale registration statement.

At closing, do purchasers in a traditional PIPE transaction receive restricted securities bearing a legend?

At the closing of a traditional PIPE transaction, purchasers receive legended securities. Typically, the resale registration statement is declared effective on the day of closing (but subsequent to the closing) or on the following business day.

Once the resale registration statement is declared effective, purchasers may deliver to the issuer's transfer agent a certificate (in contemplation of transferring or otherwise disposing of the shares) acknowledging that the purchasers recognize their prospectus delivery requirement in connection with the shares and making certain representations concerning future sales of the shares.

The issuer's transfer agent then will provide the purchasers with clean (unlegended) securities. This can happen at the closing if investors deliver their certificates to the transfer agent.

What are the benefits of traditional PIPE transactions compared to non-traditional PIPE transactions?

By comparison to a PIPE structured as a private placement with follow-on registration rights, a traditional PIPE reduces uncertainty, market risk, and illiquidity. Purchasers in a traditional PIPE are not required to close until a resale registration statement is available for subsequent sales of the shares purchased in the PIPE transaction. Traditional PIPE purchasers are able to obtain unlegended shares shortly after, or at, closing, allowing purchasers flexibility in disposing of the shares.

For most registered investment funds, securities purchased in a traditional PIPE are counted in the funds' public basket. This broadens the scope of potential investors for traditional PIPEs and also generally justifies better pricing.

Non-traditional PIPE Transactions

What are the standard terms of non-traditional (or structured) PIPE transactions?

- private placement to selected accredited investors;
- investors commit to purchase securities at a fixed price or at a variable/reset price;
- for transactions involving variable/reset pricing, the purchase agreement generally contains specific

pricing parameters – which may include a cap on the maximum number of shares that may be issued to the PIPE purchasers;

- the purchase agreements generally contain a limitation on black-out periods;
- promptly following execution of purchase agreements with investors, the transaction closes and funds;
- the issuer files a resale registration statement covering resales from time to time of restricted securities sold in the PIPE transaction;
- the issuer may be obligated to make penalty payments if it fails to file the registration statement within the allotted period, or if it fails to use its best efforts to have the registration statement declared effective within the allotted period;
- purchasers are named in the resale registration statement as "Selling Stockholders"; and
- the resale registration statement is kept effective until shares may be sold under Rule 144(k).

When does the purchaser pay for the securities in a non-traditional PIPE transaction?

In a non-traditional PIPE transaction, the purchaser pays for the securities at the closing. The closing generally is scheduled for a date promptly following the execution of all of the purchase agreements. Purchasers pay for and receive restricted securities bearing a Securities Act legend. At closing, purchasers will not have the benefit of an effective resale registration statement.

What are other closing conditions and covenants in non-traditional PIPE transactions?

- the purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement);
- for variable/reset deals, the purchase agreement also may contain covenants requiring the future issuance of additional securities by the issuer at no cost to the investor;
- 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);
- delivery of a comfort letter and legal opinions to the placement agent;
- before an investor obtains unlegended stock certificates, delivery by the investor to the issuer and the issuer's transfer agent of a certificate as to the investor's compliance with the prospectus delivery requirement; and
- closing conditions are limited to no occurrence of any material adverse change between execution and closing.

Do purchasers receive restricted (legended) securities at closing?

At the closing of a non-traditional PIPE transaction, purchasers receive legended securities. Typically, the purchasers will hold these restricted securities for a period of 60 to 90 days (or longer) following the closing. During this period, the issuer will file the resale registration statement with the SEC and seek to have it declared effective. If the issuer fails to meet any of the deadlines for filing or effectiveness outlined in the purchase agreement, the issuer may be required to make penalty payments to the purchasers.

Purchasers have limited liquidity during the pendency of the resale registration statement. Once the resale registration statement is declared effective, the purchasers will be able to sell their securities pursuant to the resale registration statement, although they will be required to deliver their legended stock certificates and a legal opinion to the transfer agent in advance of any trade. This often results in significant delays.

Pricing of PIPE Transactions

Will purchasers agree to a fixed price or a variable price?

PIPE transactions may be fixed price or variable/reset price transactions. It is important to consider whether a variable/reset price transaction includes price protection. Investors in variable/reset price deals seek "downside protection" by negotiating for rights that protect the value of their investment in the event of a downward price fluctuation. Issuers in variable/reset deals may negotiate a "cap" or "floor" to limit their exposure with respect to the maximum number of shares that may be issued as a result of stock price fluctuations or other conditions.

How is a price set?

The price is set through discussions between the placement agent and the issuer, as it is during the course of an underwritten (firm commitment) offering. Typically, PIPEs are priced at a modest discount to the closing bid price for the stock. Often, in variable/reset transactions, the price is set based on a formula that relates to the average closing price of the stock over the several days preceding the pricing.

Who bears price risk?

In a fixed price transaction, the purchaser bears the price risk during the period from execution of the purchase agreement until the closing. In a variable/reset price transaction, the price risk is shared between the investor and the company. Usually, the investor will negotiate some price protection for itself.

Other Negotiating Points in PIPE Transactions

In addition to negotiating specific carve outs for representations and warranties, the placement agent, purchaser, and issuer typically negotiate the following points:

- whether issuer's counsel will be prepared to include a 10b-5 negative assurance in its opinion;
- whether the issuer will be required to cause its independent auditor to furnish the placement agent (if any) with a comfort letter at closing;
- whether there will be a limitation on the length of black-out periods;
- whether there will be penalty payments;
- the length of time given to the issuer to have the resale registration declared effective (most often 60 days); and
- whether there will be a time limit for filing of the resale registration statement following execution of the purchase agreements.

Sharing Transaction Details with Potential Investors

Who may participate in PIPE transactions?

Accredited investors are eligible to participate in PIPE transactions. Funds, including mutual funds, pension funds, hedge funds, etc., are frequent PIPE purchasers. More recently, venture funds have begun participating in PIPE transactions. Venture funds typically negotiate for themselves additional covenants in the purchase agreements relating to corporate governance rights and information rights.

What information do investors receive?

All of the investors receive the same information: a Private Placement Memorandum containing the issuer's Exchange Act documents. Investors do not receive projections or other information that has not been disclosed publicly.

What should you tell investors before discussing details of the particular PIPE transaction?

A PIPE is a private transaction. You will be sharing information (that the issuer is considering a financing transaction) with the potential investor that is not known to the market. Before you begin discussing the details of the issuer and the offering, you should mention that it is a private transaction and obtain from the investor an oral agreement that the investor will keep such information confidential and an acknowledgement that the investor understands how such confidential information must be treated under the securities laws.

Will investors know what a PIPE transaction is?

There are many misconceptions about PIPE transactions. Typically, within each institution, there is a compliance or legal person who is familiar with the PIPE structure.

Requirements for an Issuer

What kinds of issuers finance through PIPE transactions?
Historically, PIPE transactions have been used by issuers who had significant capital requirements, including life science and biotech companies, real estate investment trusts, and technology companies. In recent years, as the volume of PIPE transactions has increased, the variety of issuers coming to market with PIPE transactions also has increased. Larger, more established issuers usually view PIPE transactions as an alternative to shelf takedowns, traditional follow-on offerings, or bought deals. Often, for larger, more established issuers, a PIPE transaction may be a means of providing liquidity to existing stockholders.

What are an issuer's typical considerations relating to a PIPE transaction?

- usually the issuer cannot issue more than 20% of outstanding stock in the PIPE transaction without shareholder approval and prior notification to exchanges;
- the purchaser (not the issuer) bears market risk;
- a short timetable provided there is no SEC review;
- the format is familiar to sophisticated institutional investors;
- PIPEs typically involve a modest discount to market price;
- the SEC is comfortable with the PIPE format; and
- PIPEs do not have any of the negative effects associated with a "death spiral" preferred or an equity line of credit (discussed below).

Must an issuer be eligible to use a Form S-3 registration statement on a primary basis in order to complete a PIPE transaction?
No, an issuer need not be S-3 eligible on a primary basis in order to complete a PIPE transaction. An issuer may use a Form S-1, a Form S-2, or a Form S-3 registration statement as a resale shelf registration statement in connection with a PIPE transaction.

Using a Form S-3 for the resale registration statement is cheaper 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.

What are the eligibility requirements for use of Form S-3 for resales?
In order to use Form S-3 for resales (secondary shares):

1. an issuer must:
   - be organized in the United States;
   - 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
   - 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
2. the issuer, and its consolidated and unconsolidated 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: (1) have failed to make any required dividend or sinking fund payment on preferred stock, or (2) 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.

May an issuer use an existing shelf registration statement to complete a PIPE transaction?
Generally, if issuers have a shelf registration statement on file, it is a primary shelf registration statement covering the sale by the issuer of newly issued securities. For a PIPE, the issuer is required to file, and have declared effective, a resale registration statement cover-

ing 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.

Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?

A PIPE transaction may require prior approval from the exchange on which the issuer's common stock is quoted if the transaction will be completed at a discount and may result in the issuance of 20% or more of the issuer's outstanding capital stock. The company should consider not only the effect of completing the proposed PIPE transaction, but also, if it has completed other private transactions within the same six month period, the aggregate effect of such transactions, all of which may be integrated. Each of the New York Stock Exchange, the American Stock Exchange, and Nasdaq has a similar requirement.

A New York Stock Exchange listed company must comply with Rule 312.03(c), which requires that the issuer obtain 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: (1) the common stock has, or will have upon issuance, voting power equal to, or in excess of, 20 percent of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or (2) the number of shares of common stock to be issued is, or will be upon issuance, equal to, or in excess of, 20 percent of the number of shares of common stock outstanding before the issuance of the common 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 private financing for cash, at a price at least as great as each of the book and market value of the issuer's common stock.

Section 713 of the American Stock Exchange 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 price less than the greater of book or market value 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 less than the greater of book or market value of the stock.

Rule 4350 of the Nasdaq Marketplace Rules requires that an issuer obtain shareholder approval in connection with a transaction other than a public offering, involving: (1) the sale, issuance or potential issuance by the issuer, at a price less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) that, together with sales by officers, directors or substantial shareholders of the company, equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or (2) the sale, issuance, or potential issuance by the company, for less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance.

Regulation FD Concerns

How does an issuer ensure that it has complied with Regulation FD in the context of conducting a PIPE transaction?

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. Generally, 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 name, 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.

Equity Lines of Credit, "Future-Priced" Securities, and Death Spiral or Toxic Converts

What is an equity line of credit?

Under an equity line of credit, the company enters into an agency 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.

What is a "future priced" security?

Death spiral or toxic converts are "future priced" securities. Future priced securities are convertible securities, often issued through a private placement or in a Regulation S offering. The conversion price or conversion ratio of the security is tied to a percentage discount to the market price of the underlying common stock at the time of conversion. As a result, the conversion price floats, or varies, based on the market price of the underlying common stock. The lower the market price of the common stock at the time of conversion, the greater the number of underlying shares that will be issued upon conversion of the security.

What is a death spiral or toxic convert?

The terms death spiral or toxic convert refer to a privately placed convertible security that has a floating conversion ratio, without a "floor." The conversion ratio of the security adjusts based upon the market price of the company's security at some point in the future, usually the time of conversion. Death spirals or toxic converts typically reset or adjust downward (to protect the investor) only, 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. Generally, the securities are placed by a hedge fund, instead of a broker-dealer. These securities may have very dilutive effects on the company's stock.

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