



PIPEs (Not the kind you smoke)



NATIONAL
LAW INSTITUTE
Continuing Legal Education

David W. Sass, Partner
Email: dsass@mclaughlinstern.com
Tel: 212-448-1100x1101
Cell: 917-836-5412

A PIPE (Private Investment in Public Equity) refers to any private placement of securities of an already public company that is made to select accredited investors. In a typical PIPE transaction, investors enter into a purchase agreement that commits them to purchase securities and usually requires the issuer to file a resale registration statement covering the resale from time to time of the privately purchased securities.

Are all public companies permitted to engage in PIPE transactions, or are there eligibility requirements?

Yes, all public companies that are reporting companies may engage in PIPE transactions.

What type of PIPE transactions are there?

There are two basic types:

- Traditional
- Non-traditional

Is there a limit to the number of purchasers that may participate in a PIPE transaction?

If all of the offerees are accredited investors, there is no limit on the number of offerees or purchasers that may participate in a PIPE transaction. However, the placement agent must take care not to engage in any marketing or sales activity that would constitute a "general solicitation."

How is "accredited investor" defined?

Rule 501 promulgated under Regulation D of the Securities Act of 1933 sets forth the definition of an "accredited investor."

An accredited investor is:

- a bank;
- a private business development company;
- an IRS Section 501(c)(3) entity having total assets in excess of \$5,000,000;
- a director, officer or general partner of the issuer;
- a natural person having net worth in excess of \$1,000,000 excluding primary residence;
- a natural person whose income is in excess of \$200,000 in each of the last two years or \$300,000 if joint with a spouse and has the expectation that the income requirement will be met in the current year;
- a trust with total assets of \$5,000,000 not formed to buy the securities in the PIPE; and
- any entity in which all equity owners are accredited investors.

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.

- 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;
- a change of control transaction; and
- a venture-style private placement for an already- public company.

What are the typical documents in PIPE transactions?

- Term Sheet
- Purchase Agreement
- Registration Rights Agreement
- Notes, Debentures and Indentures if not a stock deal
- Lock-up Agreement
- Voting Agreements
- Transfer Agent Instruction
- Legal Opinions

What are some of the advantages of a PIPE transaction?

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

- transaction expenses that are lower than the expenses that an issuer would incur in connection with a public offering;
- the issuer will expand its base of accredited and institutional investors;
- for a fixed price transactions, investors will have less incentive to hedge their commitment by shorting the issuer's stock;
- the transaction will be disclosed to the public only after definitive purchase commitments are received from investors;
- investors receive only very streamlined offering materials or information, including publicly filed Exchange Act reports; and
- a transaction can close and fund within seven to ten days of receiving definitive purchase commitments.

Some of the advantages for an investor:

- receiving a discount to the current market price (in order to compensate for the initial resale restrictions)
- typically followed by a resale registration statement
- once the SEC declares the resale registration statement effective, having unrestricted, freely tradable securities.

What are some of the weaknesses of a PIPE transaction?

PIPE transactions have a few disadvantages for issuers, including:

- investors will require a discount to market on the purchase price (in order to compensate for the initial resale restrictions);
- there will be a number of "black-out" periods for the issuer while the resale registration statement is effective. In connection with a PIPE transaction, an issuer typically must keep a resale registration statement effective for an agreed-upon length of time so that the securities may be sold freely, without reliance on Rule 144. 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 black-out periods;
- the offering can only be marketed to accredited investors;
- If the issuer's securities are listed on either AMEX or NASDAQ, an issuer cannot sell more than 20% of its outstanding stock at a discount without receiving prior stockholder approval. If listed on AMEX or NASDAQ then Form S-3 is available for registration;
- no public publicity but road shows are permitted; and
- restrictions on trading.

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 thereof) 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, and the issuer commits to filing a resale registration statement covering the resale from time to time of the purchased shares. The closing is conditioned upon, among other things, the SEC's preparedness to declare that resale registration statement effective.

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

In a traditional PIPE transaction, investors enter into a definitive purchase agreement with the issuer in which they commit to purchase securities at a fixed price. Thus, the investor bears the price risk from the time of pricing until the time of closing, a period usually ranging from three to 45 days, depending on the SEC's review of the resale registration statement. The issuer is not obligated to deliver securities to the PIPE investors if the stock price fluctuates (or for any other reason).

Investors in a traditional PIPE do not fund when they enter into a purchase agreement. Instead, the issuer 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 indicates its preparedness to declare the resale registration statement effective. Consequently, investors in a traditional PIPE transaction have a resale registration statement available at the time of closing.

Non-traditional transactions generally are structured as private placements with follow-on (or trailing) registration rights. This means that a closing is scheduled when investors enter into a definitive purchase agreement. Investors fund and the transaction closes. Post-closing, the issuer 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 issuer to file, and then to seek effectiveness of, the resale registration statement. Some PIPE transactions require the issuer to make penalty payments for failure to meet those deadlines.

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 resale registration statement for some time-usually 45 to 90 days following the closing. During that period, investors will hold restricted securities.

What are the standard terms of a traditional PIPE transaction?

A traditional PIPE transaction generally involves the following features:

- 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 resale's from time to time of the restricted securities to be sold in the transaction, naming the purchasers as "Selling Stockholders";
- closing of the PIPE transaction occurs promptly upon notice of the SEC's willingness to declare the resale registration statement effective; and

the resale registration statement is effective until shares may be sold under Rule 144 or longer, if as a result of the transaction the investor becomes an affiliate.

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.

Do investors conduct their own due diligence in a PIPE transaction?

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 transaction pay for the securities?

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

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

A traditional PIPE transaction generally involves the following closing conditions:

- the issuer must update the representations and warranties made in the purchase 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 have been 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.

Purchasers will receive legended securities at the closing. However, a purchaser can receive clean (unlegended) securities--either at the closing or afterwards--by delivering to the issuer's transfer agent a certificate (in contemplation of transferring or otherwise disposing of the shares) acknowledging that the purchaser recognizes its obligation to deliver a prospectus to any prospective purchaser of the shares and making certain representations concerning future sales of the shares.

Typically, the resale registration statement is declared effective on the day of (but subsequent to) the closing or on the following business day.

How does a traditional PIPE transaction settle?

A traditional PIPE transaction settles outside of the DTC (Depository Trust Company) system. Investors receive actual physical stock certificates representing the securities. The issuer works with its transfer agent to make arrangements for the closing of the transaction.

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

By comparison to a non-traditional PIPE transaction, which is structured as a private placement with follow-on registration rights, a traditional PIPE transaction involves less uncertainty, market risk, and illiquidity.

Purchasers in a traditional PIPE transaction are not required to close until a resale registration statement is available for subsequent sales of the purchased shares. Traditional PIPE purchasers can obtain unlegended shares at, or shortly after, closing, which allows them flexibility in disposing of the shares.

Non-traditional PIPE Transactions

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

A non-traditional (or structured) PIPE transaction generally involves the following features:

- a 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 agreement generally contains a limitation on black-out periods;
- the transaction closes and funds promptly after investors execute purchase agreements;
- the issuer files a resale registration statement covering resale's from time to time of the restricted securities sold in the PIPE transaction, naming the purchasers as "Selling Stockholders" ;
- the issuer may be obligated to make penalty payments if it fails to file the registration statement within an allotted period, or if the issuer fails to use its best efforts to have the registration statement declared effective within a defined period; and

- the resale registration statement is kept effective until shares may be sold under Rule 144. However, there are exceptions to the use of Rule 144 for Blank Check Companies and Shell Companies

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, which takes place promptly after the execution of all of the applicable purchase agreements. Purchasers pay for and receive restricted securities bearing a Securities Act legend. Unlike purchasers in a traditional PIPE transaction, purchasers in a non-traditional PIPE transaction will not have the immediate benefit of an effective resale registration statement.

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

A non-traditional PIPE transaction generally involves the following closing conditions:

- the purchase agreement contains standard representations and warranties which will be brought down at closing;
- or 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 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 have been no material adverse change since execution of the purchase agreement;
- the obligation to stay current in all SEC filing requirements.

Do purchasers receive restricted (legended) securities at closing?

Yes. At the closing of a non-traditional PIPE transaction, purchasers receive legended securities.

Typically, purchasers will hold these restricted securities for a period of 45 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 no liquidity while the resale registration statement is pending. Once the resale registration statement is declared effective, the purchasers can 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 process often results in significant delays.

Pricing and Other Negotiating Points of PIPE Transactions

Will purchasers agree to purchase securities at a fixed price or a variable price?

PIPE transactions may be fixed price or variable/reset price transactions.

Variable/reset price transactions often include price protection. For example, investors seek "downside protection" by negotiating rights for themselves that protect the value of their investment in the event of a downward price fluctuation. Conversely, issuers 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 the price set?

The price is set through discussions between the placement agent and the issuer.

Typically, PIPEs are priced at a modest discount to the closing bid price for the stock to compensate for the temporary illiquidity of the purchased shares. Often, in variable/reset transactions, the price is set based on a formula that relates to the average closing price of the stock over 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 issuer. Usually, the investor will negotiate some price protection for itself.

What are the other frequent 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:

- purchase price discounts, if any;
- warrant coverage;
- whether issuer's counsel will 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 and number of black-out periods;
- whether there will be a time limit for filing the resale registration statement following execution of the purchase agreements;
- the length of time given to the issuer to have the resale registration statement declared effective (most often 60 days); and
- whether there will be penalty payments tied to the filing and effectiveness of the resale registration statement.

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, and hedge funds, are frequent PIPE purchasers.

What information do investors receive?

All investors in a PIPE transaction 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.

Should investors sign a confidentiality agreement?

Because investors do not receive material nonpublic information, it may not be necessary for them to sign a general confidentiality agreement. However, the issuer will be sharing information (the fact that the issuer is considering a financing transaction) that is not known to the market. Thus, the placement agent and the issuer should obtain from each prospective investor an oral or written agreement stating that the investor will keep information relating to the potential offering confidential and acknowledging that the investor understands how confidential information must be treated under the securities laws. If the Placement Agent wants projections than a confidentiality agreement needs to be executed by each investor.

Requirements for an Issuer

What kinds of issuers finance through PIPE transactions?

Historically, PIPE transactions have been used by issuers with significant capital requirements.

In recent years, as the volume of PIPE transactions has increased, the variety of issuers coming to market with PIPE transactions also has increased. PIPE issuers now range in all sizes and include larger, more established companies.

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

In evaluating a PIPE transaction as a possible financing option and in considering a PIPE transaction versus other potential financing options, an issuer should generally consider the following:

- usually the issuer cannot issue more than 20% of its total shares outstanding at a discount in the PIPE transaction without shareholder approval and prior notification to exchanges;
- the purchaser (not the issuer) bears market risk;
- the transaction can close quickly, provided there is no SEC review;
- the format is familiar to sophisticated institutional investors;
- PIPEs typically involve a modest discount to market price; and
- the SEC is comfortable with the PIPE format.

Must an issuer be eligible to use a Form S-3 registration statement on a primary basis in order to complete a PIPE transaction?

Issuers need not be Form S-3 eligible on a primary basis in order to complete a PIPE transaction, but must be eligible to use Form S-3 on a resale basis. An 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, but using a Form S-3 is cheaper and less time-consuming than using a Form S-1. 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.

What are the eligibility requirements for use of a Form S-3 registration statement for resale's?

In order to use Form S-3 for resales:

1. An issuer must:
 - be organized, and have its principal business operations, in the United States or one of its territories;
 - 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 have filed all required reports in a timely manner; 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.

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 total shares outstanding. 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 integrated.

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

Private Placement with General Solicitation

New Rule 506(c) Permits Private Placements With General Solicitation

The SEC has adopted new Rule 506(c), which permits an issuer to offer and sell securities by means of general solicitation, provided that the following conditions are met.

- All purchasers of the securities must be accredited investors at the time of the sale of the securities.
- The issuer takes “reasonable steps to verify” that all purchasers of the securities are accredited investors.
- All other conditioners of existing Rules 501 (definitions), 502(a) (integration restriction) and 502(d) (resale limitations) of Regulation D are met.

Verification Required

Under Rule 506(c) issuers must take “reasonable steps to verify” that purchasers of the offered securities are accredited investors. This requirement is separate from the requirement that sales must be limited to accredited investors and must be satisfied even if all purchasers are accredited investors.

Generally, under the new Rule 506(c), it is not sufficient verification for issuers to solely rely on “self-certification” by potential investors who merely check a box in a questionnaire or sign a document containing investor representations. Verification of accredited investor status of natural persons poses greater practical difficulties than other categories of accredited investors. Natural persons may be accredited investors based on either a “net worth test” or an “income test”.

Information About the Purchaser

The more information an issuer has indicating that a prospective purchaser is an accredited investor, the fewer additional verification steps it may have to take, and vice versa. The following are examples of the types of information an issuer could rely upon:

- Publicly available information in filings with a federal, state or local regulatory body.
- Third-party information that provides reasonably reliable evidence that a person is an accredited investor, such as Form W-2 provided by a natural person.
- Third-party verification of a person's status as an accredited investor, provided that the issuer has a reasonable basis to rely on the third-party verification.

Issuer Must Keep Adequate Records of Verification Steps

The issuer has the burden of demonstrating that its offering is entitled to an exemption from the registration requirement of Section 5 of the Securities Act. Consequently, issuers and their verification service providers must retain adequate records of the steps taken to verify that a purchaser was an accredited investor.

Reports to the IRS

For verifying a natural person as an accredited investor on the basis of income, an issuer may rely on any Internal Revenue Service ("IRS") form that reports income for the two most recent years, along with obtaining a written representation from the person that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.

Financial Reports

For verifying a natural person as an accredited investor on the basis of net worth an issuer will rely on one or more of the following types of documentation, dated within the prior three months, together with a written representation from the person that all liabilities necessary to make a determination of net worth have been disclosed.

- A. For assets: bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties; and
- B. For liabilities: a consumer report (i.e., a credit report) from at least one of the nationwide consumer reporting agencies.

For Verifying a natural person as an accredited investor under either the "income test" or the "net worth test," an issuer may rely on a written confirmation from a registered broker-dealer, a registered investment adviser, a licensed attorney, or a certified public accountant that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor.

Rule 506(c) Securities are “Covered Securities” for Blue Sky Purposes

State “blue sky” registration requirements will be pre-empted and not apply to securities offered and sold in Rule 506(c) offerings.

Form D Check the Box for Rule 506(c) Offerings

Form D is the notice of sales, which is filed for an exempt offering of securities conducted under Regulation D. An issuer offering or selling securities in reliance on Rule 506 must file a Form D with the SEC for each new offering of securities within 15 calendar days after the first sale of securities in the offering. Issuers conducting a Rule 506(c) offering must indicate that they are relying on the Rule 506(c) exemption by marking a new check box in Item 6 of Form D.

Now, in addition a Form D must be filed prior to the start of the offering.

New Rule 506(d) Disqualifies "Bad Actors" From Rule 506 Private Placements

Introduction

The SEC adopted Rule 506(d), which, added "bad actor" disqualification provisions to Rule 506 of the Securities Act of 1933. These provisions render the Rule 506 exemption unavailable for an offering in which certain disqualified persons participate.

Who Is a "Bad Actor"?

The new disqualification provisions of Rule 506(d) apply to the following "covered persons:"

- the issuer and any predecessor of the issuer or affiliated issuer;
- any director, executive officer, other officer participating in the offering, any general partner or managing member of the issuer;
- any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated based on total voting power of all equity securities;
- any investment manager or an issuer that is a pooled investment fund and any director, executive officer, other officer participating in the offering, general partner or managing member of the investment manager as well as any director, executive officer or participating officer of any such general partner or managing member;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any person that has been or will be paid (directly or indirectly) for soliciting purchasers in connection with sales of securities in the offering (a "compensated solicitor"); and
- any director, executive officer, other officer participating in the offering, general partner or managing member of any compensated solicitor.

What Is a "Disqualifying Event"?

The following are "Disqualifying Events" under new Rule 506(d):

- a criminal conviction (felony or misdemeanor), entered within the last ten years for covered persons (five years for issuers): (a) in connection with the purchase or sale of any security, (b) involving the making of a false filing with the SEC, or (c) arising out of that conduct of the business of certain financial intermediaries.
- a court injunction or restraining order entered within five years before the sale, that restrains or enjoins such person from engaging in any conduct: (a) in connection with the purchase or sale of any security, (b) involving the making of a false filing with the SEC, or (c) arising out of the conduct of the business of certain financial intermediaries.
- a final order issued by the CFTC, a federal banking agency, the National Credit Union Administration or a state regulator of securities, insurance, banking, savings associations, or credit unions, that either: (a) bars the person from associating with any entity regulated by the regulator, or from engaging in the business of securities, insurance or banking or from savings association or credit union notifications; or (b) is based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within ten years of the proposed sale of securities;

- a SEC disciplinary order relating to a broker-dealer, municipal securities dealer, investment company or investment adviser that:
 - a. Suspends or revokes such person's registration;
 - b. Places limitations on the activities, functions or operations of such person; or
 - c. Bars such person from being associated with any entity or from participating in the offering of a penny stock;
- an SEC cease-and-desist order, entered within five years before the sale, relating to a violation (or further violation) of a security-based anti-fraud provision of the federal securities laws or relating to a violation of Section 5 of the Securities Act;
- a suspension, expulsion or bar from membership in an SRO or from associating with a member of, an SRO;
- an SEC stop order applicable to a registration statement or order suspending use of the Regulation A exemption within the last five years or which is the subject at the time of sale of a proceeding to determine whether such a stop or suspension order should be issued; and
- a U.S. Postal Service false representation order entered within the last five year.

Regulation FD and Other Legal 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 participants in the PIPE process. Generally, an issuer does not share any information with potential investors 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 its 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 in 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 or written agreement from each potential purchaser it contacts that information shared will be kept confidential.

What must the placement agent do in order to comply with Regulation M?

Most PIPE transactions are "distributions" for purposes of Regulation M. The placement agent must refrain from making a market in the issuer's securities during the applicable Regulation M "restricted period." Depending on the average daily trading volume of the issuer's security, the restricted period for an agent participating in a PIPE transaction is either one or five days prior to the pricing (as opposed to the funding or closing of the transaction).