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CONSIDERATIONS FOR PIPE TRANSACTIONS

To Our Clients and Friends:

Given the current volatility of the capital markets and uncertain outlook for stability, one attractive option for public companies seeking to raise capital quickly is a “PIPE” transaction – or private investment in public equity. This article highlights some key considerations that a company should consider in connection with a PIPE transaction, including information on waivers of certain rules of the New York Stock Exchange (NYSE) recently approved by the SEC in connection with the COVID-19 pandemic.

Company Charter Confirmations

A company should confirm it has sufficient unissued but authorized stock under its charter or, if the company is considering issuing a new type of equity security, such as preferred stock, that its charter authorizes such security. In calculating the number of shares available for issuance in the PIPE, a company should take into account shares reserved for issuance under equity compensation plans or convertible securities. If sufficient shares are not available or the type of security being considered is not already authorized, then a company may have to seek shareholder approval to amend its charter.

Stock Exchange Listing Rules

The 20% Rule

The rules of both Nasdaq and the NYSE require shareholder approval for the issuance of 20% or more of a company’s outstanding common stock or voting power, subject to certain exceptions. These exceptions include (i) public offerings and (ii) private placements so long as the price is above a minimum threshold tied to market price and, for NYSE transactions, marketing to multiple purchasers with no one individual or group acquiring more than 5% of the number or voting power of outstanding shares before the sale. Neither of these exemptions is typically available for PIPE transactions, which usually are marketed to a small number of investors and at a below market price. See our prior posts discussing the Nasdaq rules here and NYSE rules here. If shareholder approval is required in advance of the PIPE, then a company’s plans to raise capital could be delayed significantly.

One common workaround allowed by both stock exchanges is to issue less than 20% of shares immediately, combined with the issuance of preferred stock or another security that remains non-convertible and non-voting until shareholder approval is obtained. The exchanges may permit certain penalties and sweeteners to encourage shareholder approval, but such mechanisms must be navigated carefully after consulting with the applicable exchange.

Due to the ongoing spread of the COVID-19 virus, on April 6, 2020, the SEC declared immediately effective a proposal by the NYSE (see SEC notice here) to waive through June 30, 2020 the 5% exception limitation discussed above if the sale is for cash and complies with the NYSE's minimum price requirements.

Related Party Transactions

The NYSE requires shareholder approval for certain issuances to (i) directors, officers and 5% shareholders, (ii) affiliates thereof and (iii) entities in which the foregoing have a substantial direct or indirect interest if the issuance exceeds 1% of the number or voting power of outstanding shares before the issuance. The NYSE makes a limited exception for issuances of up to 5% of a company's shares to a shareholder that is a related party only because it is a substantial shareholder.

As part of the SEC waiver discussed above, the SEC has approved a partial waiver of the numerical limitations of the NYSE's related party transaction rule also through June 30, 2020, if the transaction is (i) a cash sale that complies with the minimum price requirements and (ii) approved by the company's audit committee or a comparable committee comprised solely of independent directors.

Although Nasdaq does not have a related party rule comparable to the NYSE's rule, it views issuances to directors and officers at below market value, similar to the NYSE, as equity compensation, which requires shareholder approval. These rules can affect PIPEs in which insiders participate.

Change of Control

Both Nasdaq and the NYSE require shareholder approval prior to transactions deemed to be a change of control. Nasdaq presumes that a change of control has occurred if an investor will cross the 20% ownership threshold as a result of the transaction. The NYSE presumes that a change of control has occurred where (i) the transaction results in an investor crossing the 20% threshold, (ii) the investor would obtain disproportionate board representation or (iii) the investor would have significant veto rights over corporate actions. Note that the recent NYSE rule waivers do not apply to the change of control requirements.

Again, transaction structuring workarounds may be available to avoid shareholder approval in the change of control context; these should be discussed with the applicable exchange.

Registration Rights

PIPE investors typically receive registration rights for the shares purchased in a private placement to allow them to sell without restrictions. The registration rights agreement negotiated between the parties often provides the investors with (i) demand registration rights requiring the company to register the sale of acquired shares pursuant to a resale registration statement and (ii) piggy back registration rights that allow investors to join in a registered primary offering of the company or a secondary offering of other company shareholders. A company should consider the rights it is willing to grant pursuant to a registration rights agreement and the fees and expenses it is willing to incur to effect the registration.

Governance Considerations

Most PIPEs involving preferred stock or other non-common equity are bespoke transactions, and many of them include heavily-negotiated board representation rights, consent rights, anti-dilution provisions, conversion and redemption features and preemptive rights. These features may implicate SEC regulations, stock exchange listing rules and state law. Each company should carefully consider what rights it is willing to provide to investors in light of these considerations.

Conclusion

PIPEs are often a fast and cost effective way to raise capital, relative to other types of transactions, but they raise complicated technical questions that must be carefully considered. Our Capital Markets and Private Equity teams are available to answer your questions about PIPEs and to assist you in evaluating structure and strategy, for both potential PIPE issuers and PIPE investors.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding these developments. For further information, please contact the Gibson Dunn lawyer with whom you usually work, or the following authors:

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