



Market Trends 2017/18: PIPEs

A Lexis Practice Advisor® Practice Note by
Ari B. Blaut, Krishna Veeraraghavan, So Yeon Kim, and Richard Le Page,
Sullivan & Cromwell LLP



Ari B. Blaut



Krishna
Veeraraghavan

OVERVIEW

This article explores trends in the private investments in public equity (PIPE) market in 2017 and the market outlook for 2018. The market for PIPEs in the United States was stable in 2017, with growth focused on middle market and small cap issuers rather than mega deals. According to PrivateRaise, a private research and data service which tracks PIPEs of \$1 million or more by U.S. issuers (see <http://www.privateraise.com>), in 2017, there were 1,716 PIPE transactions with a total dollar volume of \$81.2 billion, representing a 21.4% increase in the number of deals and a 1% increase in total dollar volume as compared to 2016. In terms of types of securities issued, common stock continued to be the most frequently issued security, representing 57.2% of the total dollar volume raised in 2017. Other common types of securities issued in PIPE transactions in 2017 included convertible preferred stock, representing 7.6% of total dollar volume, and convertible debt, representing 8.2% of total dollar volume. Oil and gas continued to be the most active industry for PIPE issuances in 2017, but the total dollar volume of transactions in that industry decreased by 25.6% as compared to 2016, reflecting the rebound in commodity prices and equity valuations for oil and gas issuers that have made public markets more attractive than in recent years. Other active industries for PIPE issuances in 2017 were technology and healthcare. In contrast, PIPE transactions in the media and metals, materials, and stones industries decreased in 2017 as compared to 2016. For more information on PIPEs, see [Raising Capital Using a PIPE](#).

DEAL STRUCTURE AND PROCESS

PIPE transactions tend to be tailored to the particular situation and often arise when issuers are distressed. Issuers may opt for PIPE transactions over a registered public offering when their stock is undervalued or they encounter a short-term liquidity crunch, as PIPEs are a good way to signal to the market that smart money, in the form of sophisticated investors, is backing the issuer. For more information on PIPE deal timing and documentation, see [Steps for Conducting a PIPE](#).

Deal Timing

Given the need for quick execution in many PIPE transactions, it is important to be mindful of timing considerations. Highlighted below are some key timing considerations.

- **Shareholder approval.** Both the Nasdaq Stock Market (Nasdaq) and the New York Stock Exchange (NYSE) require shareholder approval prior to the issuance of common stock (or securities convertible into or exercisable for common stock) in excess of 20% of common stock or voting stock outstanding prior to the issuance. Given the potential delays in obtaining shareholder approval, parties may structure around the

exchange requirements by opting for share caps, where there are multiple classes of securities, one of which is voting up to just below the 20% threshold and the other of which is either non-voting or convertible into voting stock only upon shareholder approval. In instances where shareholder approval is necessary, PIPE investors often impose punitive economic consequences if issuers fail to obtain shareholder approval in a timely manner. In addition to structuring the transaction to avoid or delay shareholder approval, parties may take advantage of exceptions to these exchange requirements. Under NYSE rules, shareholder approval is not required if the issuance is a bona fide private financing and the price paid or the conversion price is at least as great as each of the book and market value of the issuer's common stock. A bona fide private financing is a sale to either a registered broker-dealer that intends to sell the securities in private resales or to multiple purchasers where no single purchaser or group acquires more than 5% of the issuer's common or voting stock outstanding prior to the sale. However, under Nasdaq rules, acquiring more than 20% of common or voting stock in a company, irrespective of the price paid or the conversion price, will trigger the shareholder approval requirement. Although 18% of the surveyed PIPE transactions over \$100 million in 2016 required shareholder approval, in 2017, none of the surveyed PIPE transactions required shareholder approval. However, in the case of Synchronoss Technologies, Inc.'s PIPE transaction signed in October 2017 and closed in February 2018, the holders of Series A Convertible Participating Perpetual Preferred Stock were barred from exercising their conversion rights to acquire more than 19.99% of the aggregate shares of common stock issued by Synchronoss and from exercising voting rights representing more than 19.99% of the total voting power of Synchronoss until shareholder approval was obtained. For further information, see [20% Rule and Other NYSE and NASDAQ Shareholder Approval Requirements](#).

- **HSR filings.** In certain circumstances, filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (HSR), may be necessary if the parties meet the size-of-transaction and size-of-person tests. If an HSR filing is required, parties cannot consummate the transaction during the 30-day statutory waiting period, unless early termination is granted. The Federal Trade Commission (FTC) may grant early termination before the expiration of the statutory waiting period if the FTC and the Department of Justice decide that an in-depth second request review of the transaction is unnecessary. Parties may choose to seek early termination by filing a term sheet (prior to the finalization of definitive documents) with the request. However, parties wishing to keep the transaction entirely confidential should be aware that the FTC is required to publish notice of the early termination in the Federal Register and on the FTC's website.
- **Constraints in existing debt arrangements.** There may be requirements under the issuer's existing debt documents, including indentures, credit agreements, and security agreements, that may restrict the incurrence of debt and use of proceeds in subsequent equity offerings. Issuers should evaluate their existing obligations and determine whether any third-party consents are necessary.

Transaction Documentation

- **Key deal documentation.** Deal documentation in a PIPE transaction is specific to the type of instrument being purchased. In PIPE transactions for equity securities, the principal documents are typically a purchase agreement (or subscription agreement) governing the terms of the purchase of securities, a governance agreement (or shareholders' agreement) setting forth the purchasers' governance rights (such terms may also be included in the purchase agreement), a certificate of designations or amendment to the issuer's charter (in cases where a new class of securities is being issued), and a registration rights agreement (sometimes covered together with governance rights in a shareholders' agreement), which allows investors to resell securities in the public market. The latter three documents are usually filed or entered into at closing. For equity issuances, there will be a listing application, if listing is required, and agreements with agents for transfer, conversion, and dividend disbursement, as applicable. In the case of a sale of debt securities, the principal documents are a note purchase agreement, an indenture governing the terms of the notes, and a registration rights agreement. In negotiating the terms of these documents, it is important to ascertain early on

the objectives of the investor. If the investor is focused on longer term growth, governance rights and voting rights will be highly negotiated, and if the investor is focused on shorter term returns, dividends, conversion, redemption, and registration features will be more important. For more information and forms of certain documents, see [PIPEs: Drafting Key Documents](#), [Purchase Agreement \(PIPE Offering\)](#), [Registration Rights Agreement \(PIPE Offering\)](#), [Common Stock Warrant \(PIPE Offering\)](#), and [Officer's Certificate \(PIPE Offering\)](#).

- **Material non-public information.** In the event the issuer discloses to the investor material non-public information (MNPI), a non-disclosure agreement may need to be executed prior to disclosure. Regulation Fair Disclosure prohibits companies from disclosing MNPI selectively without making a prior or simultaneous public disclosure, unless the recipient of MNPI agrees to maintain confidentiality of the information provided. For more information on Regulation Fair Disclosure, see Regulation FD. For further information on materiality, see [Materiality: Relevant Laws and Guidance](#), [Determining Materiality for Disclosure Checklist](#), and [Materiality Determination Guidelines](#).

DEAL TERMS

Based on 20 PIPE transactions with deal values of over \$100 million in 2016 and 2017, below is a summary of material deal terms and trends in 2017 as compared to 2016 for these larger transactions. The data set includes some of the largest PIPE transactions in 2016 and 2017, and despite the relatively small size of the sample, it should generally be representative of the trends in larger transactions because of the relative dearth of large PIPE transactions vis-à-vis smaller transactions. Nonetheless, readers should exercise caution in drawing conclusions based on the below analysis given the size of the sample.

Type of Security

PIPE transactions involve different types of securities, the most common being common equity, convertible preferred equity, and convertible debt. As was the case in 2016, in 2017, the trend continues to favor preferred equity because it retains the upside of equity while the liquidation preference gives investors the downside protection of being senior to common equity in the event of a bankruptcy. Deals involving the issuance of convertible notes have not represented a significant portion of the surveyed PIPE deals.

- In 2017, 30% of the data set involved the sale of common stock and 70% involved the sale of convertible preferred stock, whereas in 2016, 18% involved the sale of common stock and 82% involved the sale of convertible preferred stock.

Dividends

The preferred security issuances surveyed for 2017 provided for dividend payments ranging from 3.875% to 14.5% per annum. A majority of the preferred security issuances surveyed for 2016 and 2017 included payment-in-kind (PIK) dividends, which allow the issuer to pay dividends in additional securities or by increasing the principal amount of the debt. If a security includes a PIK dividend feature, the issuer typically has the right to decide whether cash or PIK dividends will be paid. Sometimes the right to pay PIK dividends is only available for a limited period of time.

- In 2017, all of the convertible preferred security issuances surveyed provided for a combination of cash and PIK dividends. In 2016, 38% of such issuances provided for cash dividends and 62% provided for a combination of cash and PIK dividends.

Governance Rights

Governance rights tend to be one of the most highly negotiated provisions in PIPE transactions involving the sale of equity as they govern the ongoing relationship of the issuer and investor. The most common forms of governance rights are the appointment or nomination of a director or board observer (i.e., an individual who may attend company board meetings but is not a member of the board) and voting rights. On the former, board representation is usually proportional to the equity ownership of the investors and is often conditioned on the investors' maintaining ownership above a certain threshold.

- Director and/or board observer appointment/nomination rights were granted in 56% of the 2017 transactions surveyed and in 73% of the 2016 transactions surveyed. In both years, the majority of appointment/nomination rights was conditioned on ownership of a threshold percentage of securities purchased or outstanding common stock of the issuer. Director appointment rights are underrepresented in the survey because 30% of the transactions surveyed in 2017 and 27% of the transactions surveyed in 2016 involved either a sale of equity representing limited partner interests without rights to manage or govern or a sale of common stock whereby investors were entitled to vote for directors with other holders of common stock.

Standstill and Lock-up

Many investors in PIPE deals agree to standstill provisions prohibiting them from, among other things, acquiring additional securities, entering into voting agreements, or waging proxy fights for a specified period of time or until their ownership drops under a threshold level. Also, investors often agree to lock-up arrangements restricting them from transferring securities to third parties for a period typically ranging from one to three years. Given the importance of the particular PIPE investor to the issuer, this is a critical feature for issuers in PIPE transactions.

- In 2017, 44% of deals surveyed included standstill provisions and 89% included lock-up arrangements. By contrast, in 2016, 27% of the deals surveyed included standstill provisions and 72% included lock-up arrangements. The survey for 2017 demonstrated a stronger trend in the inclusion of both forms of issuer protective measures. Several of the transactions surveyed included lock-up provisions restricting transfers to certain types of purchasers, including competitors of issuers, persons who own more than a certain threshold of the issuer's outstanding common stock, or non-U.S. individuals or entities.

For a form of lock-up agreement in another context, see [Lock-Up Agreement \(IPO\)](#).

Registration Rights

As PIPE transactions are by their nature private investments, investors generally require registration of the securities to resell in the public market and obtain liquidity on their investments. All of the transactions surveyed in 2017 and 2016 included registration rights for investors, which typically contain highly negotiated provisions on the timing of filing the registration statements, number of demand rights (the investors' right to demand registration of their securities), and piggyback registration rights (the investors' right to add their securities in other registrations of securities by the issuer).

- **Demand rights.** In 2017, 44% of the data set included demand rights, compared to 27% in 2016. Although there were generally fewer demand rights in 2016, more deals included the right to receive liquidated damages in certain events, usually where the registration statement is not declared effective by the Securities and Exchange Commission (SEC) by a certain deadline, but also in instances where the registration statement is not timely filed or ceases to be effective for a certain period of time. Liquidated damages are

another way to induce the issuer to file and keep effective registration statements. A number of deals surveyed included a minimum offering amount threshold (ranging from \$1 million to \$75 million) to exercise demand rights.

- **Blackout period.** All of the deals surveyed in 2017 and 2016 included a blackout period in which the issuer may delay filing of a registration statement or suspend sales under a registration statement for certain events, with the blackout periods ranging from 30 to 120 days in aggregate per year.

Deal Terms Specific to Convertible Instruments

Conversion

PIPE transactions often involve the issuance of convertible equity or debt. When conversion is triggered, the securities usually convert into common equity.

- **Optional conversion.** 71% of convertible security issuances surveyed for 2017 provided for a conversion feature at the option of the issuer, usually exercisable starting three to four years after closing and triggered when the common stock trades above a certain price over a certain period of time. In determining the reference price of common stock, 50% used the closing price and 50% used volume-weighted average price, which averages trading prices throughout the trading day and is weighted by total volume traded that day. While the look-back period varies by deal, most deals had look-back periods of around 20 to 30 trading days. 86% of convertible security issuances surveyed for 2017 and 89% of convertible security issuances surveyed for 2016 provided for conversion at the option of the investor, exercisable immediately or after a fixed number of years from closing, usually one to five years. In both 2016 and 2017, convertibility at the option of issuers and investors is prevalent, with the latter being more frequent.
- **Automatic conversion.** In 2017, 29% of the surveyed transactions that involved convertible instruments provided for automatic conversion into common stock in connection with certain change of control events of the issuer. In addition, there were other tailored automatic conversions such as Virtusa Corporation's Series A-1 Non-Voting Convertible Preferred Stock automatically converting into Series A Convertible Preferred Stock upon the expiration or termination of the HSR waiting period. In 2016, 56% of the surveyed convertible instrument transactions included automatic conversion into common stock upon the passage of time, shareholder approval, or certain changes of control of the issuer.

Redemption

The securities offered in a PIPE transaction can either be perpetual or redeemable, with redemption at the option of the issuer or investor or upon the occurrence of certain extraordinary events.

- In 2017, excluding common stock issuances, 86% of the transactions provided for redemption at the option of the issuer and 100% at the option of the investor. In comparison, in 2016, 56% provided for redemption at the option of the issuer, 67% at the option of the investor, and 11% upon the triggering of a mandatory redemption provision. The triggers for redemption included the passage of time, change of control of the issuer, and other fundamental events.

Anti-Dilution Adjustments and Preemptive Rights

Because future issuances of securities at lower prices, stock splits, and reclassifications have dilutive effects on the ownership of investors in PIPE transactions, investors will usually include anti-dilution protections. Along the same lines, some PIPE transactions give investors preemptive rights to participate in future issuances of securities to maintain their relative ownership.

- In 2017, 100% of the deals surveyed that involved preferred stock contained anti-dilution provisions, with the most prevalent being based on broad-based weighted averages, which take into account the weighted average dilutive effect based on the size of the future offering. Also, 44% of the deals surveyed in 2017 included either preemptive rights or right of first offer (providing the investor with the right to purchase securities of the issuer prior to the issuer offering to sell to third parties). Similarly, in 2016, 100% of the surveyed transactions included anti-dilution provisions, and 36% included preemptive rights. In all of the deals surveyed, none provided for full-ratchet anti-dilution protection, which resets the conversion price to the price for the new issuance irrespective of the size of the new issuance. This aggressive form of investor protection appears to have lost ground in the market.

For additional information on anti-dilution, see [Anti-dilution Adjustment Formulas in Convertible Bonds](#) and [Antidilution Provisions in Warrants Checklist](#).

INDUSTRY INSIGHTS

Of the deals surveyed, the two most active industries were oil and gas and technology. The following is an analysis of the trends in PIPE transactions in these two industries.

Oil and Gas

The first half of 2016 saw a record downturn in crude oil prices, but prices recovered through the end of 2017. Economic downturns tend to have the effect of fueling more private investment as an alternative to public offerings, and this appears to be reflected in the 2016 results. In 2017, the oil and gas industry accounted for 25.4% of total value raised in PIPE transactions compared to 34.5% in 2016, according to PrivateRaise. As commodity prices recovered and acquisition activity normalized, PIPE activity in the oil and gas industry stabilized in 2017 with spurts of PIPE activity during the year due to a higher demand for investments resulting from infrastructure damage from hurricanes.

Technology

The technology industry is another high activity space for PIPE deals, as many issuers have constant financing needs to fund research and development and/or acquisition activity, and investors find the industry attractive due to its growth prospects and revenue models. In 2017, biotechnology deals alone accounted for 8.5% of the total value raised in PIPE transactions, compared to 6.2% in 2016, according to PrivateRaise.

2018 OUTLOOK

PIPE transactions continue to be attractive financing alternatives to registered public offerings. PIPEs often allow for relatively quick execution and flexibility compared to public issuances and provide parties with the ability to maintain confidentiality until execution, allowing issuers to avoid risks associated with an unsuccessful public issuance. Moreover, macro level developments (including the increased volatility and uncertainty resulting from legal and regulatory changes promulgated by the new administration in Washington and uncertainty about trade deals) may induce issuers to opt for PIPE transactions over registered public offerings. However, recent upticks in stock prices may raise the relative attractiveness of public markets, and newly enacted changes to U.S. tax laws may incentivize issuers to rely on internal financing by repatriating cash held offshore.

Ari B. Blaut

Partner, Sullivan & Cromwell LLP

Ari Blaut is a partner in the firm's leveraged finance, restructuring and capital markets groups. Ari maintains a broad corporate practice advising clients on a wide range of financing transactions, including bank financings, high yield bond issuances, "PIPE" transactions, debt restructurings, liability management, creditor representations and joint ventures. Ari has particular expertise in leveraged finance, acquisition finance and strategic credit transactions. Ari regularly acts for clients in connection with arranging committed debt financing (both bank and bond) for mergers and acquisitions.

Some of Ari's significant representations in the past year include, among others, advising (i) AT&T on its \$40 billion debt financing for its pending acquisition of Time Warner, (ii) Tesoro on its \$4.1 billion debt financing for its pending acquisition of Western Refining, (iii) Eastman Kodak in connection with its "PIPE" transaction with Southeastern Asset Management and (iv) the ad hoc committee of Key Energy's unsecured note holders in connection with financing matters related to the acquisition of Key Energy through its prepackaged Chapter 11.

Krishna Veeraraghavan

Partner, Sullivan & Cromwell LLP

Recognized twice as "Dealmaker of the Week" by The American Lawyer, for his work on M&A mega-deals by The Legal 500 and as Leading Lawyer by the IFLR 1000, Krishna Veeraraghavan is a partner and member of S&C's Mergers and Acquisitions Group, focusing his practice on M&A, corporate governance and private equity matters. He has represented U.S. and non-U.S. companies, special committees, boards of directors and financial advisers in public company transactions, leveraged buyouts and private company sales of subsidiaries and divisions. He is an adjunct professor at Columbia Law School.

His recent representations are from a wide range of industries including: AB InBev, Amgen, AT&T, Concordia, Cyberonics, Dyax, Eastman Kodak, Heyman Family, Highgate Hotels, Idenix, Impax, LabCorp, Lion Capital, Perrigo, Pharmasset, Synageva BioPharma, and Teva Pharmaceuticals.

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