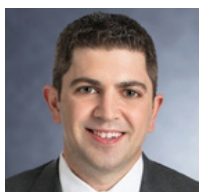


Market Trends 2020/21: PIPEs

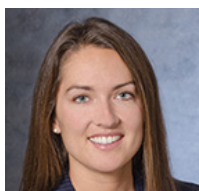
A Practical Guidance® Practice Note by
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This practice note explores trends in the private investments in public equity (PIPE) market in 2020 and the market outlook for 2021. The market for PIPEs in the United States saw an increase in both the number of deals and total dollar volume of deals that closed in 2020 compared to 2019. According to The PIPEs Report published by The Deal, there were 1,635 PIPE transactions with a total dollar volume of \$101.5 billion in 2020, as compared to 1,027 PIPE transactions with total dollar volume of \$48.3 billion in 2019. This represents a 59% increase in number of deals and a 110% increase in total dollar volume of deals from 2019.

In terms of types of securities issued, common stock continued to be the greatest proportion of securities issued, representing approximately 72% of the total dollar volume raised in 2020. Other common types of securities issued in PIPE transactions in 2020 included convertible debt, representing approximately 12.2% of the total dollar volume, and convertible preferred stock, representing approximately 8.3% of total dollar volume.

For additional information on PIPEs, see [PIPEs and Raising Capital](#) and [PIPE Transactions](#). For further information on private placements in general, see [Private Placements Resource Kit](#).

Notable Events

The volatility of the capital markets, tightening credit markets, uncertain outlook for stability, and loss of cash flow experienced by many companies at the outset of the COVID-19 pandemic contributed to the increase in PIPE activity in 2020 similar to the rise in PIPE activity following the 2008 financial crisis. The ongoing boom in popularity of special purpose acquisition companies (SPACs) also contributed to the increase in PIPE activity in 2020, as PIPEs have become a popular source of supplemental capital to finance SPAC acquisitions. Lastly, the relaxation of certain NYSE shareholder approval rules, provided increased flexibility for NYSE listed companies to engage in large PIPE transactions and PIPEs with related parties or substantial shareholders.

Increased PIPE Activity during COVID-19

During 2020, the COVID-19 pandemic created challenges for many businesses, particularly with respect to managing liquidity. Government lockdowns, social distancing measures, travel restrictions, and other preventative measures taken to contain or mitigate COVID-19 outbreaks

caused businesses to slowdown or shutdown in affected areas around the world, reducing cash flows for many companies. At the same time, COVID-19 created significant volatility in the financial markets both globally and in the United States, reducing availability of traditional sources of capital in the public markets. This was particularly true during the period from March through August 2020.

PIPEs offer publicly traded issuers an attractive alternative to traditional underwritten offerings during times of uncertainty in the financial markets. As PIPEs are exempt from the registration requirements of the Securities Act of 1933 (Securities Act), they can be completed more quickly and discretely than traditional underwritten offerings, a major advantage for a company facing urgent liquidity needs. A PIPE transaction will be disclosed to the public only after the definitive purchase agreement has been executed, allowing issuers to avoid risks associated with an unsuccessful public issuance. Investors will not typically receive any material nonpublic information about the issuer and instead rely primarily on the issuer's publicly filed reports under the Securities Exchange Act of 1934 (Exchange Act), helping to streamline the diligence process. A PIPE investment has the added benefit of signaling to the market that smart money, in the form of sophisticated investors, is backing the issuer. One disadvantage to issuers is that PIPEs are expensive. Investors will typically require a discount to the prevailing market price in order to compensate for the initial resale restrictions on the privately placed securities they purchase and the certainty of the desired proceeds. For that reason, issuers tend to turn to PIPEs when access to the cheaper public markets is unavailable or highly uncertain.

In tough economic times, investors tend to see PIPEs as an attractive way to put capital to work. Tightening of credit markets can drive financial sponsors to invest in PIPEs because of the potential for high returns and difficulty of deploying capital in other types of transactions, such as leveraged buyouts. Advantages of PIPEs for investors include the opportunity to deploy capital without the exposure of owning an entire company, favorable pricing, and a clear path to exit through registration rights.

One early example of a PIPE that occurred shortly following the COVID-19 outbreak is private equity firm Roark Capital Group's \$200 million investment in The Cheesecake Factory in April 2020. The restaurant chain struggled after closing all of its restaurant locations across the country in March 2020. In a Form 8-K filing with the Securities and Exchange Commission (SEC) on March 27, 2020, the company disclosed that it had reduced 2020 compensation for its directors, officers, and employees, furloughed approximately 41,000 hourly restaurant workers and would not be

paying April rent on leases for its restaurant locations. The company's stock price on Nasdaq plummeted from a 2020 high of \$42.25 in February to a low of \$15.10 in early April.

Later that month, on April 20, 2020, The Cheesecake Factory announced the sale of 200,000 shares of convertible preferred stock to an affiliate of Roark Capital Group, representing an approximately 16% stake (on an as-converted fully diluted basis). As a holder of preferred stock, the Roark investor is entitled to quarterly cumulative dividends on the liquidation preference at a rate of 9.5% per annum. In addition, the Roark investor has the right to convert its preferred stock into common stock at a conversion price of \$23.23 per share, representing an 18.8% premium to the company's common stock price prior to the announcement date. As part of the agreement, the Roark investor also has the right to designate one member to the company's board of directors as long as it continues to own at least 25% of the convertible preferred stock initially purchased. In the press release announcing the transaction, the company's CEO explained: "This transaction not only meaningfully enhances our liquidity position to navigate the near-term COVID-19 landscape and get our affected staff members back to work as soon as practicable, but also importantly, solidifies our ability to manage the business for the long-term for all of our stakeholders once we emerge on the other side of this crisis. Moreover, Roark's investment underscores the strength of our brands, market positioning and long-term growth prospects."

Additional examples of PIPEs that occurred shortly following the COVID-19 outbreak are Norwegian Cruise Line's \$400 million issuance of exchangeable senior notes to an affiliate of L Catterton in May 2020 and Expedia's \$1.2 billion issuance of nonconvertible preferred stock and warrants to Silver Lake and Apollo Group Management in May 2020. In both cases, PIPE investments provided critical capital at a time of unprecedented business distribution due to the travel restrictions in response to the outbreak of COVID-19.

PIPEs as a Source of Supplemental Capital for De-SPAC Transactions

Another driving force behind the increased PIPE activity in 2020 is the boom in popularity of SPACs. SPACs saw exponential growth in 2020 in terms of both dollar volume and number of deals. A SPAC is a public shell company through which a financial sponsor raises a pool of cash in an initial public offering (IPO) and places the IPO proceeds in a trust to be used to finance the acquisition of one or more private companies, also known as the De-SPAC transaction. Upon closing the De-SPAC transaction, the

combined company becomes a publicly listed company. Merging into a SPAC has become an attractive alternative to undertaking a traditional IPO or direct listing for many private companies.

PIPE investments have become one of the most important features of successful De-SPAC transactions in a couple of different respects: to fund redemptions and to finance a portion of the De-SPAC transaction. Under the terms of a SPAC, before the SPAC can close on a De-SPAC transaction, the SPAC must offer its public shareholders the option to redeem their SPAC shares for the original purchase price. The redemption right creates inherent uncertainty as to the amount of cash that will be available in the SPAC's trust account at the closing of the De-SPAC transaction after the funding of the redemptions. In order to protect a target company against this risk, the acquisition agreement typically includes as a condition to closing that a certain amount of cash must remain on the SPAC's balance sheet at closing after giving effect to all of the shareholder redemptions. Obtaining committed PIPE financing in advance of signing the acquisition agreement is often necessary to mitigate the risk of not meeting such minimum cash condition. PIPE commitments also have the added benefit of signaling to the public SPAC shareholders that key investors support the business combination.

As SPAC sponsor teams pursue increasingly large De-SPAC transactions, PIPE financings have played an increasingly significant role. It has become common for the amount of proceeds raised in the PIPE financing to exceed that raised in the SPAC IPO. For example, Churchill Capital Corp III's De-SPAC acquisition of Multiplan, Inc., which at the time it closed in October 2020 was the largest De-SPAC transaction ever completed, was financed with \$1.1 billion in IPO proceeds plus an additional \$2.6 billion from a PIPE investment consisting of \$1.3 billion of common stock and \$1.3 billion of convertible notes. As the surge in SPAC IPOs continues in 2021, we expect to see more significant PIPE investments announced concurrently with the De-SPAC transactions.

Proposed Amendments to NYSE Shareholder Approval Rules

On December 16, 2020, the New York Stock Exchange (NYSE) proposed amendments to certain of the shareholder approval requirements in Section 312.03 of the NYSE Listed Company Manual applicable to private placements in excess of 20% of a listed company's common stock, commonly known as the 20% rule, and issuances to related parties, referred to herein as the related party rule. The proposed amendments would largely codify the temporary waivers (which were put into place in 2020 in response to the COVID-19 outbreak and are currently

in effect until March 31, 2021) to these shareholder approval requirements implemented to provide NYSE listed companies with greater flexibility to raise capital in private placement transactions during the COVID-19 pandemic. In its proposal to the SEC, the NYSE explained that it observed that a significant number of companies have benefited from the flexibility provided by the temporary waivers. In addition, the proposed amendments would make the NYSE shareholder approval requirements more comparable to the existing Nasdaq requirements.

The SEC has until April 4, 2021, to either approve, disapprove, or institute proceedings to determine whether to approve or disapprove the proposed amendments. NYSE's shareholder approval rules are otherwise unchanged, so proposed transactions should be carefully reviewed under all applicable exchange rules. Please see Shareholder Approval Rules in Deal Timing under Deal Structure and Process for further information and for certain deal timing and structure considerations for PIPE transactions.

Deal Structure and Process

PIPE transactions tend to be tailored to the particular situation and often arise when issuers are distressed or for acquisition financings, as was the case this year in the context of the COVID-19 pandemic and the surge in SPACs. 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 or a transformative transaction. 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 of the key timing considerations.

- **Shareholder approval rules.** Both the NYSE and Nasdaq require shareholder approval for certain transactions, including (1) prior to the issuance of common stock (or securities convertible into or exercisable for common stock) in excess of 20% of the outstanding common stock or voting power prior to the issuance, subject to certain exceptions; (2) prior to any issuance of common stock (or securities convertible into or exercisable for common stock) to related parties (e.g., directors, officers, and substantial securityholders) or to their affiliates if the number of shares of common stock to be issued (or

the number of shares of common stock into which the securities may be convertible or exercisable) exceeds 1% of the company's outstanding common stock or voting before the issuance subject to certain exceptions (although Nasdaq does not have a specific related party rule, it views issuances to directors or officers at less than market value as equity compensation, which requires shareholder approval); and (3) where the issuance would result in a change of control (a fact-specific analysis). 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 nonvoting or convertible into voting stock only upon shareholder approval. In instances where shareholder approval is necessary, PIPE investors often impose punitive economic consequences if the issuer fails to obtain shareholder approval in a timely manner. In addition to structuring the transaction to avoid or delay shareholder approval, the parties may take advantage of exceptions to certain of these exchange requirements, as summarized below:

- o **NYSE exceptions to 20% rule.** Exceptions to the NYSE's existing 20% rule include (1) any public offering for cash and (2) private placements so long as the price is above a minimum price set forth in the rule tied to market price (the Minimum Price Condition) and the deal is marketed to multiple purchasers with no one individual or group acquiring more than 5% of the number or voting power of the outstanding shares before the sale (i.e., a bona fide private financing). The NYSE has proposed amendments to the 20% rule which would eliminate the bona fide private financing aspect of the exception. As a result, shareholder approval would not be required for issuances of more than 20% of the outstanding common stock or voting power of a company, so long as the issuance is made for cash and the Minimum Price Condition has been met, regardless of the number of investors. However, under the proposed amendments, if the proceeds of any such financing will be paid in an acquisition and the issued securities together with other securities issued in connection with the acquisition exceed 20% of the outstanding common stock or voting power of the company, then shareholder approval will be required.
- o **Nasdaq exception to 20% rules.** Under Nasdaq rules, shareholder approval is not required if the offer price is above a minimum threshold tied to market price, which minimum threshold is consistent with the NYSE's Minimum Price Condition.

- o **NYSE exceptions to related party rule.** There is a limited exception to NYSE's existing related party rule that permits cash sales to a related party that is also a substantial securityholder of the company without shareholder approval, provided such sales meet the Minimum Price Condition and do not involve more than 5% of the company's outstanding common stock. The NYSE has proposed amendments to the related party rule pursuant to which issuances of common stock (or securities convertible or exercisable into common stock) that would otherwise trigger shareholder approval under the 1% and 5% tests of the existing related party rule are exempt if the sale is for cash, meets the Minimum Price Condition, and was approved by the company's audit committee or a comparable committee comprised solely of independent directors. In addition, shareholder approval would no longer be required for issuances to subsidiaries or affiliates of related parties. However, shareholder approval would be required in the case of issuances used to fund an acquisition where the related party has a 5% or greater, or a group of related parties collectively have a 10% or greater, direct or indirect interest in the company or assets to be acquired or the consideration to be paid.

The shareholder approval rules and related exceptions are complex and may appear counterintuitive, particularly as they relate to convertible securities. Even if one of the exceptions described above is available, a PIPE transaction could be subject to shareholder approval under other applicable exchange rules, including in connection with a change of control. Therefore, issuers considering a PIPE transaction will want to consult with counsel early in the process to confirm whether shareholder approval is required or whether an exemption may be available. 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 (DOJ) decide that an in-depth second request review of the transaction is unnecessary. Parties may choose to seek early termination or start the 30-day statutory waiting period by filing a term
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sheet (prior to the finalization of definitive documents). 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. On February 4, 2021, the FTC and DOJ announced that the agencies have temporarily suspended the discretionary practice of granting early terminations during the transition to the new presidential Administration and given the unprecedented volume of HSR filings at the start of fiscal year 2021. During this period, the agencies will be reviewing the processes and procedures used to grant early terminations. The temporary suspension is expected to be brief. The agencies implemented a similar temporary suspension of early termination grants in March 2020, following the Premerger Notification Office's establishment of its e-filing system.

- **Existing debt agreements.** 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 a subsequent equity offering. Other key restrictions that may have implications for a proposed PIPE transaction include mandatory prepayments, fundamental changes, and related party transactions. Issuers should carefully review their existing debt agreements to understand the implications of an equity or convertible debt issuance and ensure that they comply with the terms of those agreements or determine whether any third-party consents are necessary.
- **Charter documents.** Issuers should review their organizational documents to ensure that they have sufficient authorized shares, whether preferred or common stock, to complete the transaction. Even if an issuer is not required to obtain shareholder approval under stock exchange rules, amendments of a company's charter to increase the authorized shares would typically require shareholder approval, which could significantly delay a transaction.

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 (1) a purchase agreement (or subscription agreement) governing the terms of the purchase of securities, (2) a governance agreement (or shareholders' agreement) setting forth the purchasers' governance rights (such terms may also be included in the purchase agreement), (3) a certificate of designations or amendment to the issuer's charter

(in cases where a new class of securities is being issued) setting forth the economic and other terms of the security, and (4) 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 (1) a note purchase agreement, (2) an indenture governing the terms of the notes, and (3) a registration rights agreement. In negotiating the terms of these documents for either equity or debt issuances, 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 [PIPE Transactions – Drafting Key Documents](#), [Purchase Agreement \(PIPE Offering\)](#), [Registration Rights Agreement \(PIPE Offering\)](#), [Common Stock Warrant \(PIPE Offering\)](#), and [Officer's Certificate \(PIPE Offering\)](#).

- **Material nonpublic information.** In the event the issuer discloses to the investor material nonpublic information (MNPI), a non-disclosure agreement may need to be executed prior to disclosure. Regulation Fair Disclosure (Regulation FD) prohibits companies from disclosing MNPI selectively without making a prior or simultaneous public disclosure, unless the recipient of MNPI agrees to maintain the confidentiality of the information provided. Potential investors may not want to be subject to extended restrictions on their ability to buy or sell the issuer's shares in the public market due to the receipt of MNPI in connection with the exploration of a transaction. As issuers consider the terms of the confidentiality agreement with potential investors, they should be prepared to address investors' requests to be "cleansed" of any MNPI promptly following completion or abandonment of a transaction. Issuers, counsel, and any financial advisors should work through these issues as they develop any wall-cross or other investor outreach procedures. For further information on Regulation FD, see [Regulation FD](#). For further information on materiality, see [Materiality: Relevant Laws, Guidance, and Determination Guidelines](#), [Materiality Determination for Disclosure Checklist](#).
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Deal Terms

Based on 30 PIPE transactions with deal values of over \$100 million in 2020, 2019, and 2018, below is a summary of material deal terms and trends in 2020 as compared to 2019 and 2018 for these larger transactions. The data set includes 10 of the largest PIPE transactions in each of 2020, 2019, and 2018, however, readers should exercise caution in drawing conclusions based on the below analysis given the small size of the sample and uptick in large PIPE transactions in 2020 compared to 2019 and 2018. Going forward, removing PIPE issuances related to SPAC transactions will likely provide a view into the non-SPAC PIPE market.

Type of Security

PIPE transactions involve different types of securities, the most common being common equity, convertible preferred equity, convertible debt, and warrants to purchase common equity (which are often issued in combination with nonconvertible equity or debt). Preferred equity is particularly attractive for PIPE investors 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. In 2020, the surveyed PIPE deals favored preferred equity, and there was also an increase in deals involving the issuance of convertible notes relative to 2019. By comparison, in both 2019 and 2018, common stock and convertible preferred equity transactions were equally represented and convertible notes represented only a small portion of the surveyed PIPE deals.

- In terms of number of transactions, in 2020, 20% of the data set involved the sale of common equity, 30% involved the sale of convertible notes, and 50% involved the sale of preferred equity. Of the deals involving preferred equity, 80% involved convertible preferred equity, while 20% involved nonconvertible preferred equity with a concurrent issuance of warrants. In both 2019 and 2018, 40% of the transactions in the data set involved the sale of common equity, 20% involved convertible notes and 40% involved convertible preferred equity.
- In terms of dollar volume, in 2020, 20% of the dollar volume of the surveyed transactions consisted of common equity, 48% consisted of preferred equity, and 32% consisted of convertible notes. In 2019, 28% of the dollar volume of the surveyed transactions consisted of common equity, 57% consisted of preferred equity, and 14% consisted of convertible notes. In 2018, 43% of the dollar volume of the surveyed transactions consisted of

common stock, 39% consisted of preferred equity, and 16% consisted of convertible notes.

Dividends/Coupons

The preferred equity issuances surveyed for 2020 provided for dividend payments ranging from 6.75% to 9.50% per annum, with 60% of the preferred equity issuances providing for step-ups in the dividend payments after specified periods. Coupons on the convertible notes issuances for 2020 ranged from 0.375% per annum to 7.00% per annum. A large majority of the preferred equity issuances and convertible notes issuances surveyed for 2020 included payment-in-kind (PIK) interest or dividends. In 2019, a small minority of the preferred equity issuances and 50% of the convertible notes issuances included PIK interest or dividends and in 2018, a large majority of the preferred equity issuances and 50% of the convertible notes issuances included PIK interest or dividends. PIK allows the issuer to pay interest or dividends in additional securities or by increasing the stated value or principal amount of the security, as applicable. If a security includes a PIK feature, the issuer typically has the right to decide whether cash or PIK interest or dividends will be paid. Sometimes the right to pay PIK interest or dividends is only available for a limited period of time.

- In 2020, 85% of the preferred equity and convertible notes issuances surveyed provided for a combination of cash and PIK interest or dividend payments, compared to 33% of the issuances in 2019 and 83% of the issuances in 2018.
 - In 2020, 66% of the preferred equity and convertible notes issuances that provided for a combination of cash and PIK interest or dividend payments permitted the issuer to determine the proportion of cash vs. PIK payments, while 34% of the preferred equity and convertible notes issuances specified when PIK payments would be required. In some cases, the rate for PIK interest or dividends was higher than the rate for cash interest or dividends and in one of the surveyed deals, the liquidation preference of the preferred equity increased at the specified PIK rate if the company failed to pay cash dividends for a specified period of time. In contrast, all of the preferred equity and convertible notes issuances in 2019 that provided for a combination of cash and PIK interest or dividend payments permitted the issuer to determine the proportion of cash vs. PIK payments. In 2018, 60% of the preferred equity and convertible notes issuances that provided for a combination of cash and PIK interest or dividend payments permitted the issuer to determine the proportion of cash vs. PIK payments, while 40% of
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the preferred equity and convertible notes issuances permitted PIK payments only for a limited period of time and in some cases the rate for PIK interest or dividends was higher than the rate for cash interest or dividends.

Governance Rights

Governance rights tend to be one of the most highly negotiated provisions in PIPE transactions 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 80% of the 2020 transactions surveyed, 60% of the 2019 transactions surveyed, and 90% of the 2018 transactions surveyed. In all three years, all or a large majority of the appointment/nomination rights were conditioned on ownership of a threshold percentage of securities purchased or outstanding common stock of the issuer.

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 an important feature for issuers in PIPE transactions.

- In 2020, 60% of the deals surveyed included standstill provisions and 90% of the deals surveyed included lock-up agreements. In 2019, 40% of the deals surveyed included standstill provisions and 80% included lock-up agreements. In 2018, 81% of deals surveyed included standstill provisions and 100% included lock-up agreements.

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. Based on publicly available

documents, 100% of the transactions surveyed in 2020, 90% of the transactions surveyed in 2019, and 81% of the transactions surveyed in 2018 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.** All of the transactions that included registration rights included demand registration rights. However, a number of the deals surveyed that included demand registration rights included a minimum offering amount threshold (ranging from \$25 million to \$200 million) to demand an underwritten offering using the shelf and/or limitations on the number of shelf takedowns that the investor can do in a given period of time.
- **Blackout period.** All of the deals surveyed in 2020, 2019, and 2018 that included registration rights 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. Of the deals surveyed in 2020, 70% involved the issuance of convertible equity or debt, as compared to 60% in 2019 and 50% in 2018. When conversion is triggered, the securities typically convert into common equity. In all three years, optional conversion was prevalent, with convertibility at the option of the investors being more frequent than convertibility at the option of the issuers. Consistent with 2019 and 2018, automatic conversion remained rare in 2020.

- **Conversion at option of issuer.** In 2020, 43% of the convertible security issuances surveyed provided for a conversion feature at the option of the issuer, as compared to 66% of the convertible security issuances surveyed in both 2019 and 2018. Conversion at the option of the issuer is typically exercisable starting two to five years after closing and triggered when the common stock trades above a certain price over a certain period of time. In determining the reference conversion price of common stock, in 2020, 33% of such convertible issuances had a fixed reference conversion price and 66% tied the reference conversion price to the closing prices of the common equity or volume-weighted average price

(VWAP) of the common equity, which averages trading prices throughout the trading day and is weighted by total volume traded that day, over the look-back period. In 2019, all of such convertible issuances tied the reference conversion price to the closing prices of the common equity or VWAP of the common equity over the look-back period. In 2018, 50% of such convertible issuances tied the reference conversion price to the closing prices of the common equity or VWAP of the common equity over the look-back period, and 50% used a fixed reference amount. While the look-back period varies by deal, most deals had look-back periods of around 20 to 30 trading days.

- **Conversion at option of investor.** All of the convertible security issuances surveyed for 2020, 2019, and 2018 provided for conversion at the option of the investor, exercisable immediately or after a fixed period of time, ranging from six months to five years.
- **Automatic conversion.** In 2020 and 2018, none of the surveyed transactions that involved convertible securities provided for automatic conversion into common stock in connection with change of control events of the issuer. In 2019, only one of the surveyed transactions that involved convertible securities provided for automatic conversion into common equity in connection with change of control events of the issuer. In that transaction, automatic conversion applied only for change of control events in which 90% or more of the consideration was cash. Although automatic conversion in connection with change of control events was not common in the three years surveyed, most deals provided for optional conversion by the holders in this respect, and a number of deals included an increased conversion rate if the securities were converted by the holders thereof in connection with a change of control event.

Redemption

Convertible 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 2020, 100% of the surveyed transactions that involved convertible securities provided for redemption at the option of the issuer and 71% at the option of the investor. In 2019, 83% of the surveyed transactions that involved convertible securities provided for redemption at the option of the issuer and 83% at the option of the investor. In 2018, 83% of the surveyed transactions provided for redemption at the option of the issuer and 50% at the option of the investor. The triggers for

redemption included the passage of time, change of control of the issuer, and other fundamental events.

- In 2020 and 2019, none of the surveyed transactions that involved convertible securities included automatic redemption upon a change of control of the issuer, whereas 16% of such transactions in 2018 included such automatic redemption.

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.

- Consistent with 2019 and 2018, in 2020, 100% of the surveyed transactions that involved convertible securities 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, 42% of the convertible security issuances in 2020 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), compared to 33% of the convertible security issuances in 2019 and 66% of the convertible security issuances in 2018.
- In all of the transactions 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

As in 2019 and 2018, two of the most active industries in terms of dollar volume for PIPE deals in 2020 were healthcare and technology. The following is an analysis of the trends in PIPE transactions in these two industries.

Healthcare

PIPE deals in the healthcare industry remained prevalent in 2020. The healthcare industry lends itself to PIPE transactions because of the significant economic challenge

driven by high research and development costs and the innovative nature of the industry. This results in increased funding needs with respect to which companies in the industry turn to PIPE investors.

Technology

The technology industry continues to be a high activity space for PIPE deals, as many technology 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.

Market Outlook

PIPE transactions are an attractive financing alternative to registered public offerings. As PIPEs often allow for relatively quick execution and flexibility compared to public issuances and provide parties with the ability to maintain confidentiality until execution, they decrease risks associated with an unsuccessful public issuance. To the extent the capital markets and credit markets remain strong, excluding SPAC-related PIPEs, there may be a decrease in PIPE transactions in 2021. Though, as the SPAC market continues to remain robust for 2021, we expect a corresponding growth in SPAC-related PIPEs.

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Ari Blaut is a partner in S&C's Finance & Restructuring Group and is co-head of the Firm's U.S. Credit & Leveraged Finance practice. Mr. Blaut 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 and creditor representations. Mr. Blaut has particular experience in leveraged finance, acquisition finance, distressed financing and private credit transactions.

Mr. Blaut is widely regarded for his work on both the bank and bond sides of transactions. Chambers USA – Nationwide (2020/2019) notes that Ari is "an 'outstanding lawyer,'" "very very business savvy," and "the quality of his work is exceptional".

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Audra Cohen is co-Managing Partner of the Firm's General Practice Group globally and serves as a co-head of the Firm's Consumer & Retail and Power and Utility Groups. She has extensive experience representing clients on a broad range of merger and acquisition transactions, including public company mergers, private company transactions and spinoffs, and advising boards of directors on corporate governance and activism matters. As an active member of the Firm's management, Ms. Cohen also serves on the Firm's Diversity Committee.

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