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PIPEs: Key Issues to Consider

As public companies look to access sources of additional liquidity, some companies are exploring the possibility of issuing equity or convertible debt on a private placement basis in a so-called “PIPE”, or a private investment in public equity, transaction. Below we discuss select issues that issuers should consider as they explore this type of financing.

1. **Stock Exchange Shareholder Approval:** Both Nasdaq and the NYSE require listed companies to obtain shareholder approval for certain issuances of common stock or securities convertible into common stock, including certain issuances of 20% or more of the issuer’s outstanding common stock. Several of the requirements particularly as they relate to convertible securities are complex and may appear counterintuitive. Both exchanges also have exceptions from the shareholder approval requirement for issuers that face financial hardships requiring prompt access to capital, although this exception is limited in scope and requires prior approval from Nasdaq or the NYSE, as applicable. Whether Nasdaq and NYSE expand their interpretation of this exception in light of COVID-19 has not yet been tested. Issuers considering a private placement (as well as certain registered offerings) will want to consult with counsel early in the process to confirm whether shareholder approval is required and whether an exemption may be available.
2. **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. Preferred equity or convertible debt also may provide issuers with greater flexibility than issuing straight common stock, given the ability to vary conversion rates, liquidation preferences, interest and dividend rates, and other terms.
3. **Change of Control Issues:** Depending on the amount and type of equity being issued and the extent that it is being issued to a small number of investors and the nature of any related changes

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in the composition of the Board of Directors, counsel should evaluate whether the transaction may result in a change of control under a company's equity incentive plans, credit documents or other contracts.

4. **Credit Agreements/Indentures:** Issuers should review their credit agreements and indentures to understand the implications of an equity or convertible debt issuance and ensure that they comply with the terms of those agreements and indentures, including with respect to any requirements relating to the use of proceeds of the issuance. Key provisions typically will include change of control, mandatory prepayment, debt and liens.
5. **Antitrust:** Depending on, among other things, the size and purpose of the investment by investors, antitrust approval (or other regulatory approval in regulated industries) may be needed in connection with the transaction. For example, the current HSR filing threshold is \$94 million, and depending on the terms of the investment, such as Board seats or other rights, the passive investor exemption from filing may not be available. Companies and investors also need to be mindful of any potential required or recommended CFIUS or similar filings. As the COVID-19 situation remains rapidly evolving and disruptive, any potential need for approval should be identified as soon as possible in order to understand how long the approval process will take in relevant jurisdictions, taking into account any potential governmental delays.
6. **Registration Rights:** For those PIPE transactions that require registration of the shares, issuers may want to consider seeking a longer period in which to register the resale of the securities in light of current circumstances affecting companies, advisers, auditors and regulators (including the SEC) that may impact the ability to prepare a registration statement and clear any related SEC review.
7. **IR:** The IR department should be prepared with a comprehensive communications plan around any PIPE transaction, particularly to the extent that investors may be alarmed by the need for perceived "rescue financing". Although investors may view an investment as positive news, if they are surprised at the issuer's need or desire to raise funds in this environment or the terms of a capital raise, the market could react negatively.
8. **Fiduciary Duties and Other Board Matters:** General counsel should be prepared to discuss the directors' fiduciary duties in connection with approving a significantly dilutive transaction. Particularly where a single investor is acquiring a sizable equity position or the potential investor has a relationship with a member of the Board or management, these issues will require careful attention in order to adequately advise and protect the Board. Counsel should also ensure that the Board is fully informed of the terms of the securities, particularly the terms of any warrants or convertible instruments that may result in additional equity being issued in the future.

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9. **Confidentiality Agreements:** 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 material nonpublic information 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 material nonpublic information 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.

10. **Disclosure Issues:** Even though the securities issued in a PIPE are issued on an unregistered basis, issuers remain subject to 10b-5 liability for material misstatements or omissions in connection with the sale of those securities and in connection with public disclosures to existing investors regarding the status of financing efforts.

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