

A PIPE By any Other Name...

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The NASDAQ and the equity markets generally has yielded more than enough pain to go around. But it has been particularly hard on biotech and other technology based companies with ongoing capital needs and often highly volatile stocks. In the current environment, biotech companies frequently find the public markets closed to them and are forced to explore alternative capital raising techniques. The inability to find an alternative can mean cutbacks in personnel, postponement of clinical trials, passing up attractive opportunities, or worse.

Three capital-raising techniques which have become important for biotech companies in recent years – PIPE (private investment in public equity) offerings, death-spiral financings, and equity lines of credit – have received considerable attention in the press. Unfortunately, biotech companies looking for financing alternatives have been poorly served by this press coverage. In too many instances, the press has

mischaracterized death-spiral financings and equity lines of credit as varieties of PIPE financings – overlooking the important differences among the three, and the distinct advantages of PIPEs. PIPEs are a specific form of private placement and do not come in many varieties. We should know. Stroock & Stroock & Lavan LLP created the PIPE financing technique in 1985, naming it, with a client, a short time later.

We created the PIPE transaction to address a particular set of circumstances that are all too common for biotech companies. Biotech companies have ongoing capital requirements to support their research and development. Many biotech company stocks are thinly traded and suffer from a high degree of volatility. The public markets open and close on the biotech sector depending on a number of factors, including the performance of the NASDAQ generally, announcements by biotech companies regarding significant trial results, sector investor fatigue, and investors' appetite for

the longer-term returns associated with biotech investments. When the public market windows open, only a limited number of biotech companies are able to finance successfully. In between these windows are long periods during which biotech companies must nonetheless raise additional funds. A PIPE makes it possible.

In a PIPE financing, a fixed number of securities are sold at a fixed price, not subject to market price or fluctuating ratios, to accredited institutional investors. A PIPE differs from a conventional private placement in one very basic way. Investors, who have agreed contractually to purchase shares, actually pay for the shares, and the transaction closes, only after the Securities and Exchange Commission advises the issuer that it is prepared to declare effective a resale registration statement covering possible future sales of such shares by the investors. The resale registration statement is kept effective until shares may be sold under Rule 144(k).

The advantages of the PIPE financing technique over

conventional private placements are obvious: issuers prefer it because they are not burdened with significant post-closing requirements, like stringent operating covenants; they are able to obtain financing quickly; and their securities may be sold at a smaller discount to market than in a conventional private placement; and investors prefer it because of the certainty of prompt liquidity. Foreign investors may participate in PIPEs provided the offering of the PIPE to the foreign investor is made in compliance with the rules and regulations of his jurisdiction. Most European jurisdictions have a 'private placement exemption' which could be satisfied easily in connection with PIPE transactions.

Biotech companies have raised over US\$1 billion over the last few years using PIPE transactions. Recent PIPE transactions in which we have participated include transactions for Amylin Pharmaceuticals, Inc. (US\$35.0 million); Triangle Pharmaceuticals, Inc. (US\$60.8 million and US\$58.2 million); Curis, Inc. (US\$46.8 million); Matrix Pharmaceutical Inc. (US\$31.3 million); ILEX Oncology, Inc. (US\$127.6 million); Cerus Corporation (US\$ 24.1 million); United Therapeutics Corporation (US\$80.0 million); Digene Corporation (US\$19.5 million); ChromaVision Medical Systems, Inc. (US\$19.9 million); and Guilford Pharmaceuticals (US\$45.3 million).

The list of the institutional investors that are regular

purchasers of securities in PIPE transactions could well be a 'Who's Who' of biotechnology investing. The investment banking firms that typically serve as agents in such transactions are leaders in healthcare banking. In short, if you look carefully at the players, what you will see is that this is a financing technique that brings together very good companies with very good investors that have made a serious, long-term commitment to the sector.

Ironically, Stroock created PIPEs to avoid most of the problems now associated with death spiral financings and equity lines of credit. Death-spiral financings and equity lines of credit result in ongoing and substantial dilution. PIPEs do not. Death-spiral financings and equity lines of credit generally involve the issuance of an adjustable number of securities, either through adjustment of the conversion price of the convertible security or through the draw down (sale of stock) under the equity lines, at a fluctuating price which is based on a discount to the issuer's then market price. These adjustable or resettable structures and their accompanying dilutive effects have nothing to do with PIPEs.

Death-spiral financings and equity lines of credit often invite shorting both by the investors in the transactions as well as by others aware of the completion of such a transaction. Because of the fixed nature of their

commitment, there is no incentive for PIPE investors to hedge by shorting the stock. In fact, shorting while a PIPE transaction is being completed would be unlawful. Death-spiral financings and equity lines of credit create a market overhang, exerting downward pressure on an issuer's securities over the life of the financing or the term of the line, which is usually a period of at least one year. A PIPE financing generally requires fewer than three weeks from start to finish. Often, death spiral financings and equity lines of credit contribute to volatility in an issuer's securities. Statistics demonstrate the opposite is true for PIPEs. The SEC has acknowledged that the delayed nature of the 'puts' and the lack of market risk resulting from the formula pricing associated with equity lines of credit differentiate equity lines of credit from PIPE financings. Consequently, the SEC views equity lines of credit as indirect primary offerings.

Although the term 'PIPE' has come to describe an increasingly large number of transactions – most of which have nothing to do with PIPEs – boards of directors of biotech companies considering alternatives to the public markets need to understand that all financing forms are not created equal. The biotech community would be better served by greater understanding of the workings of the financing techniques available when underwritten public offerings are not. ■