MORRISON FOERSTER

# FREQUENTLY ASKED QUESTIONS ABOUT PIPEs

## Understanding PIPEs

***What are "PIPEs"?***

A PIPE (Private Investment in Public Equity) refers to any private placement of securities of an already-public company that is made to selected accredited investors (usually to selected institutional accredited investors). *See "How is 'accredited investor' defined?"* In a typical PIPE transaction, investors enter into a purchase agreement that commits them to purchase securities and usually requires the issuer to file a resale registration statement covering the resale from time to time of the privately purchased securities.

Equity lines of credit are not PIPE transactions. *See "What is an equity line of credit?"* below.

***Are all public companies permitted to engage in PIPE transactions, or are there eligibility requirements?***

Yes, all public companies that are reporting companies may engage in PIPE transactions. *See* "Requirements for an Issuer" below.

***Is there a limit to the number of purchasers that may participate in a PIPE transaction?***

If all of the offerees are accredited investors, there is no limit on the number of offerees or purchasers that may participate in a PIPE transaction. *See "How is 'accredited investor' defined?"* below. However, to the extent that the issuer and the placement agent intend to rely on the exemption from the registration requirements under Section 4(a)(2) of the Securities Act of 1933, as amended (the "Securities Act") and the Rule 506(b) safe harbor, the placement agent must take care not to engage in any marketing or sales activity that would constitute a "general solicitation."

***How is "accredited investor" defined?***

Rule 501 promulgated under Regulation D of the Securities Act sets forth the definition of an "accredited investor." The definition was updated following the passage of the Dodd-Frank Act.

***What kinds of securities are sold in PIPE transactions?***

PIPE transactions may involve the sale of common stock, convertible preferred stock, convertible debentures, warrants, or other equity or equity-like securities of an already-public company.

There are a number of common types of PIPE transactions, including:

- the sale of common stock at a fixed price;
- the sale of common stock at a fixed price, together with fixed price warrants;
- the sale of common stock at a fixed price, together with resettable or variable priced warrants;
- the sale of common stock at a variable price;
- the sale of convertible preferred stock or convertible debt;
- a change of control transaction; and
- a venture-style private placement for an already-public company.

***What are some of the advantages of a PIPE transaction?***

A PIPE transaction offers several significant advantages for an issuer, including:

- transaction expenses that are lower than the expenses that an issuer would incur in connection with a public offering;
- the issuer will expand its base of accredited and institutional investors;

- for fixed price transactions, investors will have less incentive to hedge their commitment by shorting the issuer's stock;
- the transaction will be disclosed to the public only after definitive purchase commitments are received from investors;
- investors receive only very streamlined offering materials or information, including publicly filed Exchange Act reports; and
- a transaction can close and fund within seven to 10 days of receiving definitive purchase commitments.

Some of the advantages for an investor include receiving a discount to the current market price (in order to compensate for the initial resale restrictions) and, once the U.S. Securities and Exchange Commission (SEC) declares the resale registration statement effective, having unrestricted, freely tradeable securities.

***What are some of the weaknesses of a PIPE transaction?***

PIPE transactions have a few disadvantages for issuers, including:

- investors will require a discount to market on the purchase price (in order to compensate for the initial resale restrictions);
- there will be a limit on the number of "blackout" periods for the issuer while the resale registration statement is effective (*see "What is a 'blackout' period?" below*);
- as a general matter, the offering can only be marketed to accredited investors (*see "How is 'accredited investor' defined?"*); and
- an issuer cannot sell more than 20% of its outstanding stock at a discount without receiving prior stockholder approval. *See "Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?"* below.

## Traditional PIPE Transactions

***What is a traditional PIPE transaction?***

A traditional PIPE transaction is a private placement of either newly-issued shares of common stock or shares of common stock held by selling stockholders (or a combination of primary and secondary shares) of an already-public company that is made through a placement agent to accredited investors.

Investors in a traditional PIPE transaction commit to purchase a specified number of shares at a fixed price, and the issuer commits to filing a resale registration statement covering the resale from time to time of the purchased shares. The closing is conditioned upon, among other things, the SEC's preparedness to declare that resale registration statement effective.

***What is a "blackout" period?***

In connection with a PIPE transaction, an issuer typically must keep a resale registration statement effective for an agreed-upon length of time so that the securities may be sold freely, without reliance on Rule 144. During this period, the issuer may suspend the use of the resale registration statement to amend it or to remedy a material misstatement or omission. This suspension is often referred to as a blackout period. During a blackout period, PIPE purchasers will have limited liquidity, as they will not be able to rely on the resale registration statement to sell the securities purchased in the PIPE transaction. Investors will negotiate a limit on the length and number of blackout periods. A blackout period also may be referred to as a "suspension period."

***How do traditional PIPE transactions differ from non-traditional PIPE transactions?***

In a traditional PIPE transaction, investors enter into a definitive purchase agreement with the issuer in which they commit to purchase securities at a fixed price. Thus, the investor bears the price risk from the time of pricing until the time of closing—a period ranging from three to 30 days, depending on the SEC's review of the resale registration statement. The issuer is not obligated to deliver additional securities to the PIPE investors if the stock price fluctuates (or for any other reason).

Investors in a traditional PIPE do not fund when they enter into a purchase agreement. Instead, the issuer then files a resale registration statement covering the resale from time to time of those securities by the PIPE investors. The transaction closes once the SEC indicates its preparedness to declare the resale registration statement effective. Consequently, investors in a traditional PIPE transaction have a resale registration statement available at the time of closing.

Non-traditional transactions generally are structured as private placements with follow-on (or trailing) registration rights. This means that a closing is scheduled when investors enter into a definitive purchase agreement. Investors fund and the transaction closes. Post-closing, the issuer has an obligation to file a resale registration statement and use its best efforts to have it declared effective.

Typically, the purchase agreement or a separate registration rights agreement outlines specific deadlines for the issuer to file, and then to seek effectiveness of, the resale registration statement. Some PIPE transactions require the issuer to make penalty payments for failure to meet those deadlines.

In the case of a PIPE structured as a private placement with follow-on registration rights, the investor will not have the benefit of a resale registration statement for some time—usually 45 to 90 days following the closing. During that period, investors will hold restricted securities.

***What are the standard terms of a traditional PIPE transaction?***

A traditional PIPE transaction generally involves the following features:

- private placement to selected accredited investors;
- investors irrevocably commit to purchase a fixed number of securities at a fixed price, not subject to market price adjustments or to fluctuating ratios;
- purchase agreements generally contain a limitation on blackout periods;
- immediately following execution of purchase agreements with investors, the issuer files a resale registration statement covering resales from time to time of the restricted securities to be sold in the transaction, naming the purchasers as "Selling Stockholders";
- closing of the PIPE transaction occurs promptly upon notice of the SEC's willingness to declare the resale registration statement effective; and
- the resale registration statement is effective until shares may be sold free of restrictions under Rule 144.

***Does the placement agent or a lead investor control the process in a traditional PIPE transaction?***

In a traditional PIPE transaction, the process is controlled by the placement agent, rather than by a lead investor. The placement agent conducts its own business and financial due diligence.

***Do investors conduct their own due diligence in a PIPE transaction?***

Investors generally limit their diligence investigation to discussions with management and the company's independent auditors. Traditional PIPE purchasers generally do not negotiate for themselves ongoing negative covenants or covenants relating to information rights or corporate governance.

***When does the PIPE purchaser in a traditional PIPE transaction pay for the securities?***

No money is exchanged when the purchase agreement is executed. Purchasers pay the purchase price only when they are informed that the resale registration statement is ready to be declared effective.

***What are the other closing conditions for a traditional PIPE transaction?***

A traditional PIPE transaction generally involves the following closing conditions:

- the issuer must update the representations and warranties made in the purchase agreement (which are similar to those contained in an underwriting agreement) and deliver a comfort letter and legal opinions (including a 10b-5 negative assurance relating to the private placement memorandum and the resale registration statement) to the placement agent;
- there cannot have been any material adverse change since execution of the purchase agreement; and
- the SEC must have stated its willingness to declare the resale registration statement effective.

Purchasers will receive legended securities at the closing. However, a purchaser can receive clean (unlegended) securities—either at the closing or afterwards—by delivering to the issuer's transfer agent a certificate (in contemplation of transferring or otherwise disposing of the shares) acknowledging that the purchaser recognizes its obligation to deliver a prospectus to any prospective purchaser of the shares and making certain representations concerning future sales of the shares.

Typically, the resale registration statement is declared effective on the day of (but subsequent to) the closing or on the following business day.

***How does a traditional PIPE transaction settle?***

A traditional PIPE transaction settles outside of the DTC (Depository Trust Company) system. Investors receive actual physical stock certificates representing the securities. The issuer works with its transfer agent to make arrangements for the closing of the transaction.

***What are the benefits of traditional PIPE transactions compared to non-traditional PIPE transactions?***

By comparison to a non-traditional PIPE transaction, which is structured as a private placement with follow-on registration rights, a traditional PIPE transaction involves less uncertainty, market risk, and illiquidity.

Purchasers in a traditional PIPE transaction are not required to close until a resale registration statement is available for subsequent sales of the purchased shares. Traditional PIPE purchasers can obtain unlegended shares at, or shortly after, closing, which allows them flexibility in disposing of the shares.

For most registered investment funds, securities purchased in a traditional PIPE transaction are counted in the funds' public basket.

## Non-traditional PIPE Transactions

***What are the standard terms of non-traditional (or structured) PIPE transactions?***

A non-traditional (or structured) PIPE transaction generally involves the following features:

- a private placement to selected accredited investors;
- investors commit to purchase securities at a fixed price or at a variable/reset price;
- for transactions involving variable/reset pricing, the purchase agreement generally contains specific pricing parameters, which may include a cap on the maximum number of shares that may be issued to the PIPE purchasers;
- the purchase agreement generally contains a limitation on blackout periods;
- the transaction closes and funds promptly after investors execute purchase agreements;
- the issuer files a resale registration statement covering resales from time to time of the restricted securities sold in the PIPE transaction, naming the purchasers as "Selling Stockholders";
- the issuer may be obligated to make penalty payments if it fails to file the registration statement within an allotted period, or if the issuer fails to use its best efforts to have the registration statement declared effective within a defined period; and
- the resale registration statement is kept effective until shares may be sold freely under Rule 144.

***When does the purchaser pay for the securities in a non-traditional PIPE transaction?***

In a non-traditional PIPE transaction, the purchaser pays for the securities at the closing, which takes place promptly after the execution of all of the applicable purchase agreements. Purchasers pay for and receive restricted securities bearing a Securities Act legend. Unlike purchasers in a traditional PIPE transaction, purchasers in a non-traditional PIPE transaction will not have the immediate benefit of an effective resale registration statement.

***What are other closing conditions and covenants in non-traditional PIPE transactions?***

A non-traditional PIPE transaction generally involves the following closing conditions:

- the purchase agreement contains standard representations and warranties (similar to those contained in an underwriting agreement), which will be brought down at closing;
- for variable/reset deals, the purchase agreement also may contain covenants requiring the future issuance of additional securities by the issuer at no cost to the purchaser;
- the purchase agreement may, depending on the nature of the purchaser, contain ongoing covenants relating to corporate governance (board representation or observer rights, blocking rights, etc.) or information requirements (regular deliveries of public filings or other information to the purchaser);
- the issuer must deliver a comfort letter and legal opinions to the placement agent;
- each investor must deliver to the issuer and the issuer's transfer agent a certificate as to the investor's compliance with the prospectus delivery requirements in order to obtain unlegended stock certificates in the future; and
- there cannot have been any material adverse change since execution of the purchase agreement.

***Do purchasers receive restricted (legended) securities at closing?***

Yes. At the closing of a non-traditional PIPE transaction, purchasers receive legended securities.

Typically, purchasers will hold these restricted securities for a period of 45 to 90 days (or longer) following the closing. During this period, the issuer will file the resale registration statement with the SEC and seek to have it declared effective. If the issuer fails to meet any of the deadlines for filing or effectiveness outlined in the purchase agreement, the issuer may be required to make penalty payments to the purchasers.

Purchasers have limited liquidity while the resale registration statement is pending. Once the resale registration statement is declared effective, the purchasers can sell their securities pursuant to the resale registration statement, although they will be required to deliver their legended stock certificates and a legal opinion to the transfer agent in advance of any trade. This process often results in significant delays.

***Is a registered direct transaction a PIPE?***

Although some of the features of a registered direct offering (*i.e.*, sales to selected institutional investors by a placement agent) give it the appearance of a private placement, a registered direct offering is a public offering. The offered securities are sold pursuant to an effective registration statement. Investors receive a preliminary prospectus (or red herring) during the marketing phase and a final prospectus prior to closing. The offering closes through DTC and investors receive their shares through DTC rather than receiving physical certificates like they would in a PIPE transaction.

## Pricing and Other Negotiating Points of PIPE Transactions

***Will purchasers agree to purchase securities at a fixed price or a variable price?***

PIPE transactions may be fixed price or variable/reset price transactions.

Variable/reset price transactions often include price protection. For example, investors seek "downside protection" by negotiating rights for themselves that protect the value of their investment in the event of a downward price fluctuation. Conversely, issuers may negotiate a "cap" or "floor" to limit their exposure with respect to the maximum number of shares that may be issued as a result of stock price fluctuations or other conditions.

***How is the price set?***

The price is set through discussions between the placement agent and the issuer, just as it is during the course of an underwritten (firm commitment) offering.

Typically, PIPEs are priced at a modest discount to the closing bid price for the stock to compensate for the temporary illiquidity of the purchased shares. Often, in variable/reset transactions, the price is set based on a formula that relates to the average closing price of the stock over several days preceding the pricing.

***Who bears price risk?***

In a fixed price transaction, the purchaser bears the price risk during the period from execution of the purchase agreement until the closing.

In a variable/reset price transaction, the price risk is shared between the investor and the issuer. Usually, the investor will negotiate some price protection for itself.

***What are the other frequent negotiating points in PIPE transactions?***

In addition to negotiating specific carve-outs for representations and warranties, the placement agent, purchaser, and issuer typically negotiate the following points:

- whether issuer's counsel will include a 10b-5 negative assurance in its opinion;
- whether the issuer will be required to cause its independent auditor to furnish the placement agent (if any) with a comfort letter at closing;
- whether there will be a limitation on the length and number of blackout periods;
- whether there will be a time limit for filing the resale registration statement following execution of the purchase agreements;
- the length of time given to the issuer to have the resale registration statement declared effective (most often 60 days); and
- whether there will be penalty payments tied to the filing and effectiveness of the resale registration statement.

## Sharing Transaction Details with Potential Investors

***Who may participate in PIPE transactions?***

Accredited investors are eligible to participate in PIPE transactions. Funds, including mutual funds, pension funds, and hedge funds, are frequent PIPE purchasers. More recently, distressed funds and venture funds have begun participating in PIPE transactions. Distressed funds and venture funds typically negotiate additional covenants in their purchase agreements relating to corporate governance rights and information rights.

***What information do investors receive?***

All investors in a PIPE transaction receive the same information: a private placement memorandum containing the issuer's Exchange Act documents.

Investors generally do not receive projections or other information that has not been disclosed publicly.

***Should investors sign a confidentiality agreement?***

Because investors do not receive material nonpublic information, it may not be necessary for them to sign a general confidentiality agreement. However, the issuer will be sharing information (the fact that the issuer is considering a financing transaction) that is not known to the market. Thus, the placement agent and the issuer should obtain from each prospective investor an oral or written agreement stating that the investor will keep information relating to the potential offering confidential and acknowledging that the investor understands how confidential information must be treated under the securities laws. Any such agreement should contain an express agreement to refrain from trading in the issuer's securities. *See* "Regulation FD and other Legal Concerns." Given an already-public company's desire to keep information about a potential financing in the form of a PIPE transaction confidential until such time as a definitive agreement is executed, it would be inconsistent for the issuer and/or the placement agent to use general solicitation in connection with a possible transaction.

***Will investors know what a PIPE transaction is?***

There are many misconceptions about PIPE transactions, but typically, within each institution, there is a compliance or legal person who is familiar with the PIPE structure.

***PIPE transactions have received negative press in the past. How does the market view PIPEs today?***

In the past, PIPEs have been confused with death spiral transactions and equity lines of credit. *See "What is a death spiral or toxic convert?"* and *"What is an equity line of credit?"* below. Unlike PIPEs, these transactions can result in ongoing and substantial dilution. Also, the SEC's enforcement division has brought a number of actions against hedge funds and other investors in PIPE transactions that traded in advance of the public announcement of the transaction while in possession of material nonpublic information or that engaged in manipulative trading practices in connection with PIPE transactions.

PIPE deals have grown in popularity over the past few years. The types of issuers taking advantage of the PIPE structure has broadened from small companies to New York Stock Exchange traded companies. In addition, the numerous publications, websites, and conferences that cover the PIPE market have made the PIPE structure more familiar to investors.

## Requirements for an Issuer

***What kinds of issuers finance through PIPE transactions?***

Historically, PIPE transactions have been used by issuers with significant capital requirements, including life science and biotech companies, real estate investment trusts, and technology companies.

In recent years, as the volume of PIPE transactions has increased, the variety of issuers coming to market with PIPE transactions also has increased. PIPE issuers now range in size and include larger, more established companies. These issuers usually view PIPE transactions as an alternative to shelf takedowns, traditional follow-on offerings, or bought deals. In addition, many issuers use PIPE transactions to provide liquidity to existing stockholders. In some instances, where a shelf takedown may not be possible, such as in connection with financing an acquisition, a PIPE transaction may be the only choice.

***What are an issuer's typical considerations relating to a PIPE transaction?***

In evaluating a PIPE transaction as a possible financing option and in considering a PIPE transaction versus other potential financing options, an issuer should generally consider the following:

- usually the issuer cannot issue more than 20% of its total shares outstanding at a discount in the PIPE transaction without shareholder approval and prior notification to exchanges (*see "Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?"*) below;
- the purchaser (not the issuer) bears market risk;
- the transaction can close quickly, provided there is no SEC review;
- the format is familiar to sophisticated institutional investors;
- PIPEs typically involve a modest discount to market price;
- the SEC is comfortable with the PIPE format; and
- PIPEs do not have any of the negative effects associated with a "death spiral," preferred stock offering, or an equity line of credit. *See "What is a death spiral or toxic convert?"* and *"What is an equity line of credit?"* below.

***Must an issuer be eligible to use a Form S-3 registration statement on a primary basis in order to complete a PIPE transaction?***

Issuers need not be Form S-3 eligible on a primary basis in order to complete a PIPE transaction, but must be eligible to use Form S-3 on a resale basis. An issuer may use a Form S-1 or a Form S-3 registration statement as a resale shelf registration statement in connection with a PIPE transaction, but using a Form S-3 is cheaper and less time-consuming than using a Form S-1. The Form S-3 is less burdensome and may be updated by the periodic filing of Exchange Act reports, without the need to file post-effective amendments.

***What are the eligibility requirements for use of a Form S-3 registration statement for resales?***

In order to use Form S-3 for resales (secondary shares):

1. An issuer must:
   - be organized, and have its principal business operations, in the United States or one of its territories;
   - have a class of securities registered pursuant to Section 12(b) of the Exchange Act or a class of equity securities registered pursuant to Section 12(g) of the Exchange Act, or be required to file reports pursuant to Section 15(d) of the Exchange Act; and
   - have been public and have timely filed all required filings for a period of at least 12 calendar months immediately preceding the filing of the Form S-3 and have filed all required reports in a timely manner; and
2. The issuer, and its consolidated and unconsolidated subsidiaries, must not, since the end of the last fiscal year for which certified financial statements of the issuer and its consolidated subsidiaries were included in an Exchange Act report: (1) have failed to make any required dividend or sinking fund payment on preferred stock or (2) defaulted on the terms of any borrowing or on any long-term lease, which defaults in the aggregate are material to the financial position of the issuer and its consolidated and unconsolidated subsidiaries, taken as a whole.

***May an issuer use an existing shelf registration statement to complete a PIPE transaction?***

Generally, if an issuer has a shelf registration statement on file, it is a primary shelf registration statement covering the sale by the issuer of its newly issued securities. An issuer may have a shelf registration statement on file that includes primary (issuer) shares and secondary (selling stockholder) shares. In that case, the issuer may be able to use that registration statement for a PIPE and name the PIPE purchasers as the "selling stockholders." Generally, though, the issuer must file and have declared effective a resale registration statement covering the resale by the PIPE purchasers (a selling stockholder shelf registration) from time to time of the securities that were purchased in the PIPE transaction.

***Does a PIPE transaction require any prior approvals from regulatory agencies or self-regulatory organizations?***

A PIPE transaction may require prior approval from the exchange on which the issuer's common stock is quoted if the transaction will be completed at a discount and may result in the issuance of 20% or more of the issuer's total shares outstanding. The issuer should consider not only the effect of completing the proposed PIPE transaction, but also, if the issuer has completed other private transactions within the same six-month period, the aggregate effect of such transactions, all of which may be aggregated by the exchange. Each of the New York Stock Exchange, the NYSE American LLC, and Nasdaq has a similar requirement.

A New York Stock Exchange-listed company must comply with Rule 312.03(c), which requires that the issuer obtain shareholder approval prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if: (1) the common stock has, or will have upon issuance, voting power equal to, or in excess of, 20% of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or (2) the number of shares of common stock to be issued is, or will be upon issuance, equal to, or in excess of, 20% of the number of shares of common stock outstanding before the issuance of the common stock or of securities convertible into or exercisable for common stock. Shareholder approval is not required under this rule if the common stock is sold in a private financing for cash, at a price at least as great as each of the book and market value of the issuer's common stock.

Section 713 of the NYSE American LLC Company Guide requires that an issuer obtain shareholder approval for a transaction involving (1) the sale, issuance, or potential issuance by the company of common stock (or securities convertible into common stock) at a price less than the greater of book or market value which, together with sales by officers, directors, or principal shareholders of the company, equals 20%

or more of presently outstanding common stock; or (2) the sale, issuance, or potential issuance by the company of common stock (or securities convertible into common stock) equal to 20% or more of presently outstanding stock for less than the greater of book or market value of the stock.

Rule 5635 of the Nasdaq Marketplace Rules requires that an issuer obtain shareholder approval in connection with a transaction other than a public offering, involving: (1) the sale, issuance or potential issuance by the issuer, at a price less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) that, together with sales by officers, directors or substantial shareholders of the company, equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or (2) the sale, issuance, or potential issuance by the company, for less than the greater of book or market value, of common stock (or securities convertible into or exercisable for common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance.

Shareholder approval also may be required by the rules of the securities exchanges for a private placement completed in connection with an acquisition, or a private placement that results in a change of control, or a private placement involving related parties.

## Regulation FD and Other Legal Concerns

***How does an issuer ensure that it has complied with Regulation FD in the context of conducting a PIPE transaction?***

An issuer is owed a duty of confidence from its agents, such as its placement agent, accountants, and other participants in the PIPE process. Generally, an issuer does not share any information with potential investors that has not already been included in the issuer's Exchange Act reports.

A private placement memorandum for a PIPE transaction usually contains the issuer's Exchange Act reports, together with legal disclaimers. It is prudent to limit the information contained in the private placement memorandum unless the issuer will be receiving signed confidentiality agreements. Although the issuer is not sharing material nonpublic information about its business with potential PIPE investors, the issuer is sharing its plans concerning a potential financing transaction. The fact that the issuer is contemplating a PIPE transaction may itself constitute material nonpublic information. This will depend on the particular facts and circumstances. In any event, however, an issuer will not want to be forced to make a premature disclosure regarding a financing.

The issuer should ensure that, before the placement agent reveals the issuer's name, the placement agent obtains an oral or written agreement from each potential purchaser it contacts that information shared will be kept confidential, and that agreement contains an explicit undertaking on the part of the potential purchaser to refrain from trading in the issuer's stock.

Given that an issuer that is contemplating a PIPE transaction generally seeks to preserve its flexibility and only make a disclosure once definitive agreements have been executed, it is unlikely that an issuer will want to engage in any form of general solicitation, even if permissible.

***What must the placement agent do in order to comply with Regulation M?***

Most PIPE transactions are "distributions" for purposes of Regulation M. The placement agent must refrain from making a market in the issuer's securities during the applicable Regulation M "restricted period." epending on the average daily trading volume of the issuer's security, the restricted period for an agent participating in a PIPE transaction is either one or five days prior to the pricing (as opposed to the funding or closing of the transaction). The placement agent also must file a Regulation M notice with FINRA.

***What are the sources of the "primary" versus "secondary" offering questions that some issuers have received in connection with resale registration statements that have been reviewed?***

Certain issuers that have filed resale registration statements to cover the resale of shares originally offered in a PIPE transaction have received comments from the SEC questioning whether it is appropriate for the issuer to use a resale registration statement (rather than a primary registration statement) for those shares, particularly in the case of PIPE transactions involving convertible securities. This is especially the case for small cap issuers, as well as for issuers that have sold a disproportionately large number of shares in a PIPE, which has been understood to mean shares in excess of 33% of the total shares outstanding prior to the PIPE transaction.

In these cases, the SEC will take a look at the facts and circumstances of the issuance and the resale registration statement. The SEC will look at the factors it outlined in its 1997 interpretative guidance.

Specifically, the SEC will consider: the amount of securities involved; how long the securities have been held; whether the investors are at market risk from the time they purchase the securities; the circumstances under which the securities were acquired; and whether it appears the seller is acting as a conduit for the issuer. Of course, to the extent the SEC is comfortable that the private placement was properly completed, the issuer can proceed with the use of the resale registration statement.

The SEC has said that in instances where it will not permit the resale registration statement to proceed, the issuer can cut back the number of shares and then file a second resale registration statement for the shares that were cut back.

## Equity Lines of Credit, "Future Priced" Securities, and Death Spiral or Toxic Converts

***What is an equity line of credit?***

Under an equity line of credit, the company enters into an agency agreement with an investor pursuant to which the company has the right, during the term of the equity line and subject to certain conditions, to put its securities to the investor.

Some equity lines of credit are completed using a shelf registration statement and others are completed as private placements with an obligation to register the resale of the securities sold under the equity line.

***What is a "future priced" security?***

Future priced securities are convertible securities, often issued through a private placement or in a Regulation S offering. For example, death spiral or toxic converts are "future priced" securities. *See "What is a death spiral or toxic convert?"*

The conversion price or conversion ratio of the security is tied to a percentage discount to the market price of the underlying common stock at the time of conversion. As a result, the conversion price floats, or varies, based on the market price of the underlying common stock. The lower the market price at the time of conversion, the greater the number of underlying shares that will be issued upon conversion.

***What is a death spiral or toxic convert?***

The terms death spiral or toxic convert refer to a privately placed convertible security that has a floating conversion ratio, without a "floor." The conversion ratio of the security adjusts based upon the market price of the company's securities at some point in the future, usually at the time of conversion. Death spirals or toxic converts typically reset or adjust downward (to protect the investor) not upward (to protect the company).

Death spirals or toxic converts typically are priced at some discount to the company's closing bid price over a period of days preceding the pricing date. This price can be manipulated easily. Generally, the securities are placed by a hedge fund, instead of a broker-dealer. These securities may have very dilutive effects on the company's stock.