

DEAL POINTS SHORT TAKES 2022.01: USE A PRIVATE PLACEMENT MEMORANDUM

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Some of the private placement/exempt from public registration methods to raise capital in the U.S. securities market require only very limited financial and other information to be disclosed to prospective investors, tempting the securities issuing company to dispense with a private placement memorandum or offering circular. That's especially the case for "Accredited Investors," defined in the securities regulations as those not needing a private placement memorandum's level of disclosure because of their net worth, income, financial sophistication or securities issuing company insider status. But even when a private placement memorandum is not required by the securities regulations, it's usually a bad and penny-wise mistake to dispense with one, unless selling securities only to institutional investors like private equity and venture capital firms, hedge funds and others that are not only Accredited Investors, but professional institutional investors used to doing their own due diligence, for two main reasons.

Deal Point: When raising capital in a private placement, unless selling only to institutional investors, use a private placement memorandum: it is the best insurance policy and the best prospectus.

Best Insurance Policy: A private placement memorandum disclosing basic quantitative and qualitative information about the securities issuer is the best insurance policy and not expensive compared to the protection it provides. It memorializes the financial and other disclosures made pre-sale, and can serve as the best evidence refutation to a disgruntled investor later claim of securities fraud, misrepresentation or omission to state a material fact in reliance upon which the investor purchased, often allowing the issuer company to avoid litigation altogether or move to summarily dismiss the investor's complaint, avoiding being dragged into the civil discovery process and ultimately forced into a nuisance settlement.

Best Prospectus: A private placement memorandum is also the best prospectus. If the company issuer has a good investment story to tell, it should tell it in a private placement memorandum; if well executed, it will encourage the prospective investors to invest. Moreover, even institutional investors, and certainly Accredited Investors, family offices, trusts, and other potential investors are used to seeing and analyzing qualitative and quantitative, including financial, information in the general private placement memorandum format, and may be disconcerted and dissuaded from investing if they are not furnished with it; they know the format and how to quickly find the information they want to see.

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Explanation and Takeaways

The value of the private placement memorandum as an insurance policy has come up a few times. In one case, contacted by a disgruntled investor that wanted to recoup its investment, whether feeling that our issuer company client wasn't hitting its milestones quickly enough or some other cause for buyer's remorse, and the issuer accused by investor's attorney of omission to state material facts, potentially securities fraud, we were able to quickly point to one or two of the private placement memorandum's statement of "risk factors," which immediately made clear to the investor's attorney that a claim of omission to state a material fact would be immediately dismissed and pointless: the complained-of risks had been disclosed in the private placement memorandum. In another case, it was the private placement memorandum's business description section that made clear that no omission to state a material fact had occurred. In a third, the private placement memorandum's financial information section made clear that no fraud had occurred. But in all three cases, a well-prepared private placement memorandum made all the difference to fend off the lawsuit threat by an investor seeking a pretext to recoup its investment and avoid a nuisance lawsuit and settlement that might have ruined the company.

As for the private placement memorandum as a prospectus, of course even the best prepared one cannot guarantee a given investor will invest in a given company. But we have often seen experienced investors using the private placement memorandum to find the information they are seeking rapidly, focus on those items, and develop the indispensable sense that, of the hundred deals they looked at that week, our issuer company was one of the well-managed ones and a viable investment vehicle.

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