Points to Consider for Your Private Placement Memorandum

A private placement memorandum or PPM is the main information document for potential investors. It's like a business plan on steroids, adding required and recommended details and legal language for an offering. It goes by many names, including offering circular, prospectus, etc. but its purpose is the same: To fully inform potential investors about the offering. This post will cover points an offeror needs to decide for its PPM.

Of course, nothing in a PPM can be misleading, but a PPM must also meet one of the major rules of securities offerings: Everything must be disclosed that a potential investor might reasonably want to know before investing. That means if there is any doubt about whether to disclose something, it should be disclosed.

In addition to the purchase price, the PPM needs to set out all of the attributes of the securities. This includes whether the investors' percentages of ownership can be "diluted" by bringing in future investors (which is generally the case). The PPM needs to address what kind of voting rights (if any) the securities being offered have. It also should state whether the securities being offered have any preferences over other securities in terms of distributions or dividends or the liquidation of the company. In addition, the PPM must describe any rights of first refusal or buy-back rights the other investors or the company have. Any conversion rights need to be addressed, for example from preferred stock to common stock, or from promissory notes to equity.

Because generally there is no resale market for private placement offerings, the exit strategy for investors must be disclosed. Is the objective to eventually go public, be purchased by another company, or close the company and distribute the assets after certain events? What dividends, distributions or interest, if any, are to be paid in the meantime? Does the company automatically acquire the investors' ownership after certain amounts are paid? LLC's and S corporations, of course, may pay shares of profits annually, subject to maintaining a specific amount or percentage for a reserve.

Each type of offering also has investor requirements. That should be considered in choosing the type of offering that will be used and in which states the securities will be offered.

Further, the PPM should set out a minimum purchase amount per investor so that, among other things, the company does not wind up with a large number of small investors, which can take a large amount of administrative time.

The offeror generally will want to set a date for the end of the offering and minimum and maximum amounts for the total offering – and state what happens if the minimum is not met. If the minimum is not met by the target date, do the investors immediately get the money back, or does the offeror continue to try to raise money?

The management team (officers and directors) and their backgrounds also must be discussed. If any have prior bankruptcies or prior securities violations, that will have to be disclosed, although explanations can also be provided. Still, that may make a difference as to who is on the management team.

Note that the existing amount and type of ownership holdings in the company must be revealed. In addition, the identity of shareholders holding 5% or more of the company must be disclosed, along with their relationship to the company.

Finally, besides disclosing general risks (the nationwide economy, possibility of future legislation, risks to the industry as a whole), the PPM must discuss risks that are specific to the company making the offering.

Many other items need to be covered in a PPM, of course, but the discussion above lists a number of the major decisions the organizers have to make in planning an offering.

–Bruce E. Methven

For more information on securities laws, head to Background on the Securities Laws: http://thecaliforniasecuritiesattorneys.com/?page_id=41

To join the email list, go to http://thecaliforniasecuritiesattorneys.com/ and complete the eNews signup box.

Forward To a Friend: http://tinyurl.com/forward-to-friend

The foregoing constitutes general information only and should not be relied upon as legal advice.

You are welcome to copy and distribute this document for non-commercial purposes, but it may not be edited and the prior warning and the following must be left on it:

Bruce E. Methven, 2232 Sixth Street Berkeley, CA 94710
Phone: (510) 649-4019; Fax: (510) 649-4024
www.TheCaliforniaSecuritiesAttorneys.com
CaliforniaSecuritiesAttorneys@gmail.com
Copyright 2012 Bruce E. Methven, All Rights Reserved.