

Private Placement Subscription Agreements (a PPM Companion Contract): Basics & Summary

In nearly any private placement offering, while the PPM (private placement memorandum) is the core *disclosure* document, it is not in itself a *contract*, nor is it the final word on the process. Another critical contract, the *subscription agreement*, is what actually transfers your company's securities to the investors (i.e., shares, units, etc.). However, the subscription agreement has many more critical functions that protect the private placement issuer from all manner of liability and contingencies. The subscription agreement not only binds the investor to certain rules, but it is the document whereby the investor warrants that it possesses the characteristics necessary under the law to actually invest (e.g., Regulation D and/or crowdfunding rules).

Read below for our overview of this vital contract and be sure that in setting up your own private placement offering, your attorneys ensure your subscription agreement carries these vital provisions:

- 1. Core Functions:** The three main functions of a subscription agreement are to: 1) outline all the terms of the securities offering and communicate them to the investor; 2) reiterate language often featured in a private placement memorandum, namely risk factors pertaining to the very real possibility that the investor will lose all of its money on the proposed investment; and 3) transfer title of the subject company securities (units, share, etc.) from the company to the investor.
- 2. Securities Legends:** The subscription agreement typically begins with an *extremely* prominent warning in a bold, all capitalized block of disclaimer language. That block commonly sets forth state specific disclaimers regarding the nature of the securities offering, the fact the offering has not been registered, any restrictions on the securities offering and any exemptions it may fall under. These core disclaimers are designed to immediately notify the investor that this is a private securities offering, which has not been registered with any securities authority or agency, and therefore carries certain significant restrictions.
- 3. Subscription Section:** Following the securities legend, there commonly is a section that sets forth the basic parameters of the securities offering. For example: 1) the number of the particular class of securities offered for sale (e.g., units, shares, etc.); and 2) the price of each unit of the security and the minimum purchase an investor can make (sometimes, they are required to buy more than one unit of the security unless the company otherwise consents). This section also sets forth other core offering terms under which the company is offering this investment (e.g., minimum/maximum offering thresholds, expiration dates, etc.). Finally, this section commonly refers to the other core offering documents, such as the private placement memorandum, shareholders or operating agreement that the investor might need to refer to for further information about the securities offering.
- 4. Investor Representations and Warranties Section:** One of the core functions of the subscription agreement is to assure the investor makes certain key representations to support the company's use of a private offering exemption (e.g., Regulation D). These representations and warranties are often grouped within several categories which are broken down further below.



Investor Exemption Representations—These representations and warranties confirm the following: 1) the investor acknowledges that the securities offered for sale are offered in reliance on certain securities offering exemptions (e.g., Regulation D); 2) the investor acknowledges the securities offered for sale have not been registered under any state or federal law; 3) the investor acknowledges the company is not obligated to register the securities offered for sale.

Investor Status Representations—These representations and warranties confirm the investor satisfies certain definitional requirements, namely that the investor is accredited and possibly sophisticated as well (“accredited investors” are defined under the income and asset thresholds set forth in SEC Rule 501; “sophisticated” refers to a qualitative level of financial knowledge that may vary between different securities offerings. Accredited investors may be individuals or entities.)

Investor Risk Acknowledgements—These representations and warranties confirm the investor understands the investment risks, as well as the following: 1) that the investor is able to fully absorb such a financial risk and potentially the loss of the entire investment; 2) that the investor was not offered any guarantee of investment return; 3) that there is no public market for the securities offered; and 4) that in no event shall the investor be permitted to resell the securities offered, without first registering it under the Securities Act of 1933 or securing an applicable exemption for resale.

Investor Information Warranties—These representations and warranties confirm any information provided to the investor is true and accurate. Moreover, the investor confirms that if there are any material changes to that information, the investor will immediately notify the company. Secondly, this section confirms the investor was given any and all the information and materials reasonably required to facilitate the investment, including being given the opportunity to read the subscription agreement, the operating agreement (or shareholders agreements), the private placement memorandum, and any other reasonably necessary documents. Finally, this section confirms the investor was given the opportunity to ask questions and receive answers.

5. Understandings Section: The understandings section sets forth additional acknowledgements on the part of the investor that are crucial to avoid liability, prevent litigation, and maintain compliance with regulation D offering exemptions. For example the investor may confirm: 1) that the agreement might be rejected by the company; 2) that it understands it could lose all its investment; 3) that it is bound to this agreement if it is accepted by the company; 4) that this agreement has not been evaluated for fairness or accuracy by any federal or state agency; 5) that the investor might not be able to sell, transfer or otherwise dispose of the units unless they register the units under the Securities Act of 1933 and/or state securities laws; 6) that both this agreement and the operating agreement (or shareholders agreements) must be kept confidential; 7) that the investor should seek advice from their personal tax advisor and not the company; and 8) that the company might be taxed as a corporation instead of an LLC, which could substantially reduce investor’s return.

6. Power of Attorney Section: This section allows a designated party, other than the investor, to execute documents which are necessary to effectuate the subscription agreement’s terms that may arise after the subscription agreement is executed. It is designed to provide a mechanism to avoid forcing the issuing company to secure an investor signature in connection with each such new document.



7. Indemnity Section: This section indemnifies the issuer company (and often the company manager and members as well). Indemnification is the promise to guard or secure against a third party claim, liability, loss, fine, expense, or damages brought or awarded against the issuer due to false or incomplete information that the investor provides. Such information is not limited to information provided in the subscription agreement, but rather includes information provided in any documents and agreements shared between the investor and the company, such as the subscription agreement, the operating agreement (or shareholder agreements), and the private placement memorandum.

8. Investor Information and Questionnaire: This section often consists of a questionnaire, whereby the investor verifies the accuracy of certain key information about its status and qualification to invest in the securities offering. For example, the investor may attest to: 1) being accredited and/or sophisticated; 2) what kind of an investor they are (individual, joint, corporate, etc.); 3) their state of residence; and 4) their level of sophistication and knowledge of private securities and company trade, products or services, industry, business opportunity, etc.

9. Miscellaneous Section: This section sets forth common terms regarding assignability, waiver, enforceability of the subscription agreement, etc.

10. Acceptance Section: This section makes clear that the investment relationship is not binding unless and until the company manager accepts the subscription agreement on behalf of the company, which such acceptance can be provided or denied solely in the manager's discretion. Once the company accepts the agreement, the investor is bound by the subscription agreement and, often via the subscription agreement, bound by the company operating agreement or shareholder agreement, as well.