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WHAT'S THE DEAL? Series

Negotiating Private Placement Engagement Letters

April 16, 2025

Is it a securities offering?

- Often the first question that we receive from bankers is whether an engagement will involve an offer or sale of securities
- This may stem from the fact that the bank is being engaged from a broad advisory mandate, which may encompass advising a company on strategic alternatives, including M&A and that may include a minority sale
- A minority sale involves a sale of securities of the company
- In the context of that minority sale, generally, the bank may act as a placement agent and will expect to be paid a fee in connection with its services, but it usually will not be the principal aspect of the advisory relationship
- This is just one example of such a situation
- It's easy to contemplate others. For example, in a restructuring or a recapitalization, the bank may be engaged as a financial adviser, and it may be rendering a variety of services—acting as a placement agent introducing the company to potential institutional investors in connection with the offer and sale of its securities may be just one of the components of the mandate
- Recall, loans are not securities (*Kirschner v. J.P. Morgan* (2023)) and part of a banks mandate may be to arrange a loan

What's in a name?

- Does it matter whether the bank structures the arrangement with the company as a financial advisory role or as a placement advisory engagement?
- Sometimes
- It may be indicative of the company's and the bank's expectations regarding the types of services that the bank will be rendering over the term of the engagement. And, in that vein, how the bank's fees are to be earned, which may be important should the payment of fees ever come to be an issue. It may also be important in connection with future services—for example, if the engagement letter has a right of first refusal, right of first offer, or a tail, and any of this is triggered based upon the prior rendering of particular banking services
- Also, of course, there are basic principles of agency law:
  - As an agent, the bank can participate in negotiations between the company and investors and assist in the actual placement of securities sold by the company
  - Technically, as an agent, the bank has the authority to commit the company, though most bank engagement letters specifically note that the company retains the right to reject any order or subscription from an investor
  - As an adviser, the bank does not assist in the actual sale of the securities. Rather, the bank's role is limited to advising the company on the structure and terms of the placement transaction. As an adviser, the bank does not have the authority to commit the company

What's in a name? *(cont'd)*

- The bank must make required disclosures regarding its capacity in the transaction:
  - The bank's capacity (financial adviser, placement agent, strategic adviser, etc.) in a transaction and who it represents
  - Other material information
  - Potential conflicts of interests in connection with the transaction (for example, any board seats that affiliates may hold on the company's board; any equity interests that affiliates may own in the company; any securities of the company that affiliates may own or that affiliates may own or are committed to purchase; etc.)
- The nature of the role will impact the bank's:
  - Internal processes such as committee approval
  - FINRA licensed individuals
  - Diligence obligations
  - Cross border restrictions

What is the “transaction”?

- How is the transaction with which the adviser or agent is being retained defined?
- Is it solely a securities transaction?
  - “*Transaction*” shall mean, whether effected directly or indirectly or in one transaction or a series or combination of transactions, any proposed offering and sale of securities of [COMPANY] (the “*Company*”) or any of its subsidiaries of equity, equity-linked or convertible securities (including, without limitation, common stock, preferred stock, warrants, options, other equity interests and any securities convertible into or exchangeable for equity) (collectively “*Securities*”), irrespective of the amount or type of consideration received therefor, to any prospective investor
  - Or it is broader?
- Generally, the adviser or the agent will specify that it
  - “shall be obligated only to perform the Services on a “best efforts” basis and makes no commitment, and shall have no obligation, express or implied, to purchase or place the Securities and shall have no liability to the Company if any prospective purchaser fails to consummate a purchase of any of the Securities.”
- Is there a benefit associated with defining the scope of services and detailing the elements of the “services”?

Exclusivity of the engagement

- Is the adviser or agent the exclusive adviser or agent? Or exclusive as to a specific mandate?
  - Even if the bank is exclusive for the mandate, it will want to protect itself against competing financings
- If not, then, to the extent the company engages multiple placement agents, language should be added to the engagement letter that
  - Each placement agent is acting in a non-exclusive capacity
  - Identifies the jurisdictions in which each agent is engaged if limited geographically
  - Acknowledges (from each agent) the designated role in relation to the other agent
  - No agent assumes responsibility or liability for the actions of the other engaged agents
- Determine if agents are signing separate engagement letters or a single engagement letter with all placement agents included on the letter
- Is a fee sharing agreement amongst the placement agents necessary or advisable? Regardless, each agent should review every other engagement letter for diligence purposes

Exclusivity of the engagement *(cont'd)*

- Sample language:
  - The Firm understands that the Company also may engage other persons or entities (each an "Other Agent") to act as a placement agent in connection with the proposed sale, through a private placement, whether in one or a series of transactions, of the Company's common equity, preferred equity (including perpetual, redeemable, convertible or any combination thereof), convertible debentures, any other equity-linked securities, mezzanine financing and/or any debt securities pursuant to a separate agreement. It is expressly understood and acknowledged that the Firm and any Other Agent are not and will not be deemed for any purpose to be acting as an agent, joint venturer or partner of the other, and that neither the Firm nor any Other Agent assumes responsibility, express or implied, for any actions or omissions of, or the performance of services by the other, in connection with any placement of securities, services or otherwise.
  - Without the consent of the Bank, the Company agrees that during the term of the Bank's engagement hereunder it will not pursue any financing transaction which would be in lieu of a sale of Securities hereunder

Section 4(a) versus Regulation 506

- Why choose one over the other, and when?
- Section 4(a)(2) is the statutory private placement exemption. Appropriate for advisory mandates that might involve strategic advice, including M&A that may also include a sale of securities. Appropriate for advisory or agented engagements wherein sales are being made to institutional investors, including institutional accounts and institutional accredited investors.
- Generally, all cross-border and US debt private placements are made in reliance on Section 4(a)(2) rather than Regulation D. This is a market in which the offers and sales are generally solely made to QIBs and institutional accredited investors and these are buy-and-hold investors, buying long-term securities for investment.
- In a Section 4(a)(2) private placement, there will be:
  - No required bad actor diligence (or disclosure)
  - No Form D filing
  - However, some law firms may not be prepared to deliver a “no registration” opinion in the context of a Section 4(a)(2) private placement, despite the ABA Federal Regulation of Securities Law Opinions Committee guidance that opinions may be delivered

Section 4(a) versus Regulation 506 *(cont'd)*

- Are you including any accredited investors that are not "institutional accounts"? "institutional accredited investors"? If so, perhaps an argument to rely on Rule 506
- In a Rule 506(b) transaction, the engagement letter will need to contain:
  - Bad actor representations from the adviser/agent
  - Bad actor disclosures from the adviser/agent (or these would have to be delivered prior to "time of sale")
  - Bad actor representations from the company
  - A representation from the company regarding no general solicitation or general advertising
  - A covenant from the company not to file a Form D without the prior review and approval of the adviser/agent and its counsel
  - A covenant from the company to use its best efforts to deliver (or a closing condition) an opinion of counsel regarding no registration

Section 4(a)(2) Private Placement

- Section 4(a)(2) of the Act provides a statutory exemption from registration for an offering, "by an issuer not involving any public offering."
- What is a "public offering"? It has never been formally defined by the SEC, although several factors have emerged from case law and SEC rulings that set out when transactions are not deemed to involve a public offering for purposes of Section 4(a)(2):
  - Investor sophistication/qualification
  - Investor access to information about the issuer
  - Prohibition on general solicitation and advertising to market the securities
  - Transfer restrictions and purchase with investment intent (no view to distribute)
  - Limited number of investors
- It is critical that the engagement letter addresses these items in order to help document a valid private placement.

Regulation 506: has anything changed?

- The SEC under the new administration is focused on capital formation and, in particular, on the private markets
- On March 12, 2025, the SEC staff issued an interpretive letter related to compliance with Rule 506(c) of Regulation D in connection with a generally solicited offering of securities
- This interpretive letter was unnecessary in that it simply restates guidance that already was in the market and had been well-understood since 2013 when the SEC amended Rule 506. In addition, SIFMA had articulated guidance on verification in Rule 506(c) offerings in 2014—see https://www.sifma.org/wp-content/uploads/2017/05/sifma-guidance-on-rule-506c-verification.pdf
- Rule 506(c) provides a principles-based method for verification of accredited investor status as well as a non-exclusive list of methods that can be sufficient to constitute "reasonable steps"
- What does the interpretive letter say?
  - In the letter, the SEC staff stated that if an issuer "requires purchasers to agree to certain [high] minimum investment amounts," along with other written purchaser representations and related conditions, it could "reasonably conclude" that it had taken "reasonable steps" to verify accredited investor status under the principles-based method of verification

Regulation 506: has anything changed? *(cont'd)*

  - If the terms of the offering require a high minimum investment amount, then the likelihood of that purchaser satisfying the definition of accredited investor may be sufficiently high such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take no additional steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by a third party

- Does this mean more companies will want to use Rule 506(c)? And how does this affect placement agents?
- If the company uses Rule 506(c), then, quite a number of considerations, including the following:
  - For a public company, one of the great benefits of a private placement is that the transaction is unannounced until definitive securities purchase agreements have been entered into
  - For any company, if the company relies on Rule 506(c), the Form D requires that the issuer "check the box" on Form D identifying use of (c) rather than (b) so that the SEC can track that general solicitation has been used—this may raise questions from the SEC subsequently regarding the materials that were used, as well as from state securities regulators (the securities may be "covered securities," but the offering is still subject to state securities fraud rules)

Regulation 506: has anything changed? *(cont'd)*

- We foresee that this new flexibility may be most appealing in the case of certain offerings by funds, by BDCs, by nontraded BDCs, by nontraded REITs, and by similar entities.
- However, extremely important for a placement agent to consider all of the ramifications of a generally solicited offering. FINRA 2210 may be triggered in an offering in which general solicitation is used. FINRA Rule 2210(a)(5) defines a "retail communication" as "any written (including electronic) communication that is distributed or made available to more than 25 retail investors within any 30 calendar-day period." FINRA members can be liable for violations of Rule 2210 when distributing or using noncompliant retail communications prepared by a third party. Notice 20-21, at p. 3.
- If material (and this might include material that may not have been solely prepared by the agent) is deemed to be a "communication" under Rule 2210, it is subject to FINRA'S "fair and balanced" content standards, as well as internal approval and recordkeeping requirements.
- Examples of the type of materials that might be picked up by this include: web pages that promote the offering, slide presentations, pitch decks, 'teasers," fact sheets, sales brochures, executive summaries, and investor packets.

Regulation 506: has anything changed? *(cont'd)*

- In addition, in the context of funds and similar vehicles, there are references to the sponsor, the sponsor's track record, the performance of other vehicles. This may be problematic. A FINRA member's communication with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. There are specific rules related to the use of performance.

Consequences of Failing to Satisfy a Private Placement Exemption

- Recall, the Act requires all offers and sales (including resales) of securities to the public in the U.S. to registered with the SEC or qualify for an available registration exemption
- The sale or resale of securities that are not SEC registered and do not qualify for an exemption from registration is a violation of the Act (this failure is known as "gun jumping")
- Consequences of gun jumping may include:
  - Resigning as placement agent and foregoing any fees
  - Breaking trades/placements and impose a cooling off period before commencing a new offering
  - Severe reputational risk
  - Regulatory inquiries and litigation
- Managing "gun jumping" risk: engagement letter and subscription agreement provisions, "no registration" opinion and applicable certificates, process control (e.g., is the company reaching out to potential investors?)

Who will be solicited?

- The engagement letter will specify the categories of persons that the adviser/agent will contact and also will address whether (and the extent to which) the company may include other persons
- Generally, preferable to limit outreach to: QIBs, institutional accounts (as defined by FINRA rule), and institutional accredited investors
- Why? Various considerations including the following:
  - Applicability of Regulation Best Interest for the adviser. "Best-interest" standard of conduct for broker-dealers and natural persons who are associated persons of a broker-dealer (unless otherwise excepted) when they make a recommendation to a retail customer of any securities transaction or investment strategy involving securities
    - The general obligations of SEC Reg BI are satisfied by in the case of sales to retail customers by fully complying with four component obligations: the Care Obligation, the Disclosure Obligation, the Conflict of Interest Obligation, and the Compliance Obligation
  - Rule 2111 (suitability) remains applicable for recommendations to institutional customers in certain circumstances
  - Due diligence obligation—applicable, regardless of whether institutional or retail
  - Rule 5123 filing with FINRA (generally to be avoided)
  - Requirement, in the case of sales to natural persons, to address KYC and AML

Rule 5123 reminders

- FINRA Rule 5123 applies to a "private placement," which means "a non-public offering of securities conducted in reliance on an available exemption from registration under the Securities Act"
- The definition does not apply to securities offered pursuant to:
  - Sections 4(a)(1), 4(a)(3), and 4(a)(4) of the Securities Act (which generally exempt secondary transactions);
  - Sections 3(a)(2) (offerings by banks), 3(a)(9) (exchange transactions), 3(a)(10) (securities subject to a fairness hearing) or 3(a)(12) (securities issued by a bank or bank holding company pursuant to reorganization or similar transactions) of the Securities Act; and
  - Section 1145 of the Bankruptcy Code (securities issued in a court-approved reorganization plan that are not otherwise entitled to the exemption from registration afforded by Section 3(a)(10) of the Securities Act)
- FINRA Rule 5123 exempts other types of private placements from the notice filing requirement, including:
  - Offerings sold by a member solely to any one or more of the following purchasers:
    - Institutional accounts, as defined in FINRA Rule 4512(c);
    - Qualified purchasers, as defined in Section 2(a)(51)(A) of the 1940 Act;

Rule 5123 reminders *(cont'd)*

- Qualified institutional buyers (QIBs), as defined in Rule 144A under the Securities Act;
- Investment companies, as defined in Section 3 of the 1940 Act;
- An entity composed exclusively of QIBs;
- Banks, as defined in Section 3(a)(2) of the Securities Act;
- Employees and affiliates of the issuer;
- Knowledgeable employees as defined in Rule 3c-5 under the 1940 Act;
- Eligible contract participants, as defined in Section 3(a)(65) of the Exchange Act; or
- Accredited investors as defined in Rules 501(a)(1), (2), (3) or (7) under the Securities Act

Also excludes the following types of offerings:

- Offerings of exempted securities, as defined in Section 3(a)(12) of the Exchange Act;
- Offerings made pursuant to Rule 144A under the Securities Act or Regulation S;
- Accredited investors as defined in Rules 501(a)(1), (2), (3) or (7) under the Securities Act;
- Offerings of exempted securities, as defined in Section 3(a)(12) of the Exchange Act;
- Offerings made pursuant to Rule 144A under the Securities Act or Regulation S;

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Rule 5123 reminders *(cont'd)*

- Offerings of exempt securities with short-term maturities under Section 3(a)(3) of the Securities Act and debt securities sold by members pursuant to Section 4(a)(2) of the Securities Act so long as the maturity does not exceed 397 days and the securities are issued in minimum denominations of $150,000 (or the equivalent thereof in another currency);
- Offerings of subordinated loans under Rule 15c3-1 (Appendix D) under the Securities Act;
- Offerings of "variable contracts," as defined in FINRA Rule 2320(b)(2);
- Offerings of modified guaranteed annuity contracts and modified guaranteed life insurance policies, as referenced in FINRA Rule 5110(h)(2)(D);
- Offerings of non-convertible debt or preferred securities by issuers that meet the transaction eligibility criteria for registering primary offerings of non-convertible securities on Forms S-3 or F-3;
- Offerings of securities issued in conversions, stock splits and restructuring transactions that are executed by an already-existing investor without the need for additional consideration or investments on the part of the investor;
- Offerings of securities of a commodity pool operated by a commodity pool operator, as defined in Section 1a(11) of the Commodity Exchange Act;
- Business combination transactions as defined in Rule 165(f) under the Securities Act;
- Offerings of registered investment companies;
- Offerings of standardized options, as defined in Rule 238 under the Securities Act; and
- Offerings filed with FINRA under FINRA Rules 2310, 5110, 5121 and 5122, or exempt from filing thereunder in accordance with FINRA Rule 5110(h)(1)

Structuring fees in the engagement letter

- Retainer fee?
  - [Retainer Fee. The Company hereby agrees to pay Placement Agent on or prior to the date of this agreement a retainer fee (a "*Retainer Fee*") equal to US$[●]. The Retainer Fee shall be non-refundable, provided that if an Offering is consummated, the Financing Fee (as defined below) shall be reduced by the amount of such Retainer Fee.]
- Any paid retainer fees are typically credited against the placement agent fee
- Financing Fee: percentage of the gross proceeds raised in the placement and payable on the closing date of the transaction
- What triggers payment of the fee?
  - Is it "consummation" of the "transaction"?
  - How is "consummation" defined or understood in the context of the letter?
  - How is "transaction" defined?
  - Is there one or is there a series of transactions?
  - Is there a minimum fee trigger under the letter?
  - Are there payments of expenses along the way?

Structuring fees in the engagement letter *(cont'd)*

- Might structure fees in order to provide for different fee percentages depending upon the total amount raised, the time period that has elapsed for the engagement or for different types of investors that participate in the placement
- Excluded investors (if any) should be identified and scheduled in the engagement letter
- Any warrants issued to the placement agent as compensation should be addressed
  - Consider the effect of warrants (or other equity instruments) under Rule 5110 for future public offerings
- Ensure that placement agent fees are payable if a placement were to occur during the tail period but proceeds from the placement are not received until the tail period expires
- Consider a late penalty charge provision
  - The Company will pay to the Firm, at a rate equal to **[**twelve**]** percent (**[**12**]**%) per year, a monthly late payment charge (the "Late Payment Charge") on the unpaid balance of any fees or expenses not timely paid in full.

Expense reimbursement

- Regardless of whether any placement occurs, the Company should be responsible to reimburse the placement agent for all expenses (separate from any placement agent fees that are owed)
- Includes the fees and expenses of legal counsel to the placement agent
- Common for companies to request a limit or cap on the expense reimbursement amount
  - Can limit to just legal counsel expenses
  - Should exclude any expense reimbursement relating to the indemnity from the limitation
  - The company's consent to exceed the limitation should not be unreasonably withheld or delayed
- Reimbursement should be promptly made at the placement agent's request from time to time
- Sample language: Whether or not any Placement of Securities is consummated, and in addition to any fees payable to the Firm, the Company will reimburse the Firm, upon its request from time to time, for all expenses incurred by it in entering into and performing services pursuant to this Agreement, including the fees, disbursements and other charges of its legal counsel.

Representations, warranties and covenants

- Placement agents take varying approaches in terms of addressing company representations, warranties and covenants in engagement letters
- Generally, at a minimum, most engagement letters will address the following representations from the company:
  - No integration of offerings;
  - No general solicitation or general advertising;
  - Reliance on Section 4(a)(2), and covenant regarding no reliance on Regulation D and as a result no filing of a Form D;
  - No offers or sales to any person that is not an IAI, QIB or an institutional account;
  - Accuracy of any disclosure materials furnished to the placement agent;
  - Access to information as necessary for investors;
  - Ensuring that the placement agent will expressly be named as a third-party beneficiary at least with respect to the representations and warranties of the investors in the securities purchase agreement; and
  - Certain FCPA, AML, and sanctions representations

Representations, warranties and covenants *(cont'd)*

- Similarly, most engagement letters will tend to address the following covenants from the company:
  - Best efforts to provide access to all necessary diligence or data room materials;
  - Preparation of offering materials by the company;
  - Coordination of all outreach through placement agent and direction of all investor inquiries received by company during term of engagement to placement agent;
  - General good faith cooperation covenant; and
  - Covenant to amend or update any disclosure materials for the occurrence of any material development
  - Prepare and submit necessary state or local filings associated with the private placement

Right of First Refusal

- As part of the engagement, the company may be required to engage the placement agent or its affiliate in connection with any future transaction
  - Future transactions may include (1) a future private placement of securities, (2) an acquisition or disposition if a financial adviser is engaged, (3) financing with any financial institution, (4) public offering of securities, or (5) interest rate, currency or foreign exchange, derivative or hedging arrangements or treasury product services
- Is the ROFR on an exclusive basis? Customary terms and conditions?
  - Ensure that the term "Securities" is broadly defined in the engagement letter as the applicability of the ROFR will likely depend in part of that definition
- Identify the length of the ROFR
  - Under Rule 5110, FINRA considers a ROFR with a term in excess of three years to constitute unreasonable compensation
- Define the role and any economics that is covered by the ROFR (i.e., lead book-running manager with 30% economics)

Right of First Refusal *(cont'd)*

- Sample language
  - As a further inducement to the Firm for accepting this engagement, the Company agrees that during the Term and for a period of [thirty-six ([36]) months] following the Term, the Firm shall have a right of first refusal to act in an exclusive capacity as financial advisor, capital markets advisor, placement agent, exchange agent, dealer-manager, arranger, or book-running lead manager, as the case may be, in connection with any (1) acquisition or disposition transaction for which the Company will engage a financial advisor, (2) private placement of Securities, (3) financing with any bank, insurance company or other financial institution, (4) public offering of Securities, or (5) interest rate, currency or foreign exchange, derivative or hedging arrangements or treasury product services, in each case under a separate agreement containing terms and conditions customary for the Firm and mutually agreed upon by the Company and the Firm.

Tail provisions

- Most engagement letters provide for a "tail fee" provision of some sort that is intended to compensate the bank for its work and its introductions during the term of the engagement letter even if a transaction (as defined in the engagement letter) is consummated after the term of the engagement letter between the company and a party introduced to the company by the bank
- When does the tail fee provision begin to apply? Does it apply only from the date of termination of the letter? What services are subject to the tail fee?
- Is it different if the engagement letter provides for an exclusive engagement as opposed to a non-exclusive engagement?
- Placement agent entitled to compensation for a transaction that closes for any investor with whom the company had contact during the term of the engagement letter, regardless of how the contact was initiated
  - All contact with investors will occur through the placement agent and in the engagement letter the company will covenant that it will direct all investors and other potential expressions of interest to the placement agent during the term of the engagement

Tail provisions *(cont'd)*

- Generally, most tail provisions are 12 to 24 months
- Generally, the agent will not be compensated if the agent was terminated by the company for cause (i.e., gross negligence)
- What happens if a deal is announced during the tail period but closes outside of the tail period? Should the triggering event for payment of the fee be announcement of (or signing) a deal or the consummation of the deal?
- Courts generally have enforced the right of banks to be paid under tail fee provisions regardless of arguments made by companies that have claimed that the bank did not work on the subject transaction or that the work it performed was alleged to be inadequate or that the transaction that eventually was consummated was different than that contemplated by the engagement letter—courts have looked at the overall realities of the transaction and the benefit of the bargain that was struck when the engagement letter was signed
  - *Moelis & Co. LLC v. Ocwen Fin. Corp.* (2022)
  - *Peter J. Solomon Co., LLP v. ADC Prod. (UK) Ltd.* (2016)
  - *Stormharbour Securities LP v. IIG Trade Opportunities Fund, N.V.* (2015)

Key person provision

- A company may want to include a key person provision in an engagement letter
- This is more common in an advisory engagement letter as opposed to an engagement letter for a securities transaction
- A key person provision specifies that one or more specific bankers must be available to the company and part of the team advising the company; in turn, should they not be available to the company, this would trigger a termination of the engagement as well, generally, as a termination of the tail provisions under the letter
- Typically, there is a cure right (replacement with a similar banker) and potentially staggered or modified fee construct

Foreign issuer considerations

- Engagement letter should note that all fees, expenses and any other amounts must be payable in U.S. dollars, free and clear of any non-U.S. value-added taxes, withholding taxes or deductions
- If the company is required to make any deduction or withholding relating to non-U.S. taxes, the company should be required to pay additional amounts such that the net amount received by the placement agent after all such deductions and/or withholding is not less than the sum that would have received had no such deduction or withholding been required or made
- Company should appoint an agent for service of process for any proceeding arising out of the engagement letter
- Address choice of law, submission to jurisdiction, venue, etc.
- Include any required foreign selling legends in the offering materials
- Consider any foreign filings, wall-crossing considerations (EU MAR) and placement agent licensing and cross border execution
- Not technically a 4(a)(2) or Regulation D offering if completely offshore private placement

Termination

- Engagement letter should expressly state the initial term (typically 12 months)
  - Are there any express renewal provisions?
  - Or does the term continue until the letter is expressly terminated?
- Engagement letter may be terminated by either party during the term with 30 days' prior written notice to the other party
- May be terminated immediately by the placement agent upon the occurrence of a regulatory event
- Fee provision, expense reimbursement, ROFR, tail and indemnity survive any termination
- Engagement letter may automatically terminate upon the closing of a placement
  - Consider the impact on a placement with multiple closings
- Require written notice of any termination to set the date for the commencement of the ROFR and tail periods

Termination *(cont'd)*

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- Sample language
  - The Firm's services hereunder may be terminated by the Company or the Firm upon 30 days' prior written notice, and may be terminated immediately by the Firm by written notice to the Company if a Regulatory Event (as defined below) occurs, in each case, without liability or continuing obligation of the Company or the Firm, except that (i) the Firm shall be entitled to all fees payable hereunder in accordance with the terms and subject to the conditions thereof and (ii) all expenses incurred by the Firm as a result of services rendered prior to the effective date of the termination for which the Firm is entitled to reimbursement hereunder shall become immediately payable in full, and provided that the right of first refusal contemplated hereunder and the Tail Period contemplated hereunder shall remain operative and in full force and effect regardless of any termination.

Indemnification and Exculpation

- Identify the financially appropriate entity or affiliated group of entities to provide the indemnity
  - Consider in the case of a to-be-formed vehicle, as well as in the case of a company that has a sponsor or an external manager
- Should broadly cover any claim, suit, action, proceeding, investigation or inquiry, including any shareholder or derivative action or arbitration proceeding
- Applicable in the event of any alleged material misstatement or omission in any offering materials or any matter in any way directly or indirectly relating to or referred to in the engagement letter (includes both a transactional and disclosure indemnity)
- Common carve-out is if it is judicially determined (no longer subject to appeal) that applicable losses resulted solely from the gross negligence, bad faith or willful misconduct of the placement agent in performing the services that are the subject of the engagement letter
- If indemnification is unavailable or insufficient, the company agrees to contribute to the losses in the proportion appropriate to reflect the relative benefits received by it from the transaction
- No mutual indemnities

Liability

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- Private placements ***are*** subject to:
  - Section 17(a) (the antifraud provision) of the Securities Act
  - Section 10(b) (the antifraud provision) and Section 20(a) (the "control person" provision) of the Exchange Act
  - State securities laws ("Blue Sky" laws)
  - State common law of fraud and negligent misrepresentation
  - FINRA suitability, advertising and supervisory rules
- Who "made" the misstatement?
  - Under Rule 10b-5, it is unlawful for "any person, directly or indirectly, . . . [t]o make any untrue statement of material fact" in connection with the purchase or sale of a security

Confidentiality provisions

- To the extent a confidentiality agreement has not been previously entered into between the placement agent the Company, the engagement letter should include standard non-disclosure obligations
- Term of the confidentiality provision is often 12-24 months regardless of the term or termination of the engagement letter
- Should be limited to the information provided by the Company that is both material and not already publicly available information
- Include a carve-out for any confidential information is that requested or required to be disclosed by law or litigation
- Provision will typically include a notice provision for any information that the placement agent is requested or required to disclose to a third party
  - The Company may seek a protective order or other appropriate remedy; provided that no such prior notification shall be required (I) in respect of any disclosure to regulatory authorities (including self-regulatory organizations) having jurisdiction over the Firm in response to a general request for information made in the ordinary course of business not specifically directed at, or relating to, the Company or (II) to the extent that the Firm is subject to a confidentiality restriction from so notifying the Company

Other updates & reminders

- Various important updates in this area from FINRA
- In December 2024, FINRA proposed amendments to various rules that affect offerings, and these were contained in and summarized in FINRA Notice 24-17, 24-17-Reg-Notice-Capital Formation.pdf (including Rules 5110, 5121, and 5123)
- In March 2025, FINRA requested comment on various of its rules relating to capital formation (the comment period closes in May). This request for comment is contained in FINRA Notice 25-06. The specific questions posed solicit feedback on various rules, including Rules 2210, 2241, 2242, 2310, 5110, 5121, 5122, 5123, 5130, and 5131, which we all deal with on a daily basis. See, regulatory-notice-25-06.pdf.
- Also in March 2025, FINRA launched another broader request for comment in connection with an effort to modernize its rules. This request for comment also subsumes capital formation rules, including those emanating from the JOBS Act, and is contained in Regulatory Notice 25-04, Regulatory-Notice-25-04.pdf.

Due diligence and FINRA Regulatory Notice 23-08

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FINRA Regulatory Notice 23-08

- FINRA Regulatory Notice ("RN") 23-08 updates and supplements prior guidance, including FINRA RN 10-22 (Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings), in light of developments in the unregistered offering market and the related regulatory framework since 2010.
- RN 23-08 highlights a member's obligation, when recommending a security, to conduct a reasonable investigation of the security.
- RN 23-08 also addresses certain additional obligations for members when selling private placements, including FINRA filing requirements and FINRA's communications with the public and supervision rules.
- Importantly, RN 23-08 does not create new regulatory requirements or new interpretations of existing requirements. Moreover, RN 23-08 does not relieve firms of any existing obligations under federal securities laws and regulations.
- RN 23-08 focuses on a member's role, when recommending private placements, in performing **reasonable investigations** under the reasonable basis obligations of Regulation Best Interest ("Reg BI") (specifically, the Care Obligation thereunder), FINRA's suitability rule (FINRA Rule 2111) and caselaw interpreting the antifraud provisions of the federal securities laws.

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FINRA Regulatory Notice 23-08 *(cont'd)*

- What constitutes a reasonable investigation depends on the facts and circumstances, including the nature of the recommendation, the role of the broker in the transaction, its knowledge of and relationship to the issuer, and the size and stability of the issuer (e.g., more thorough investigation is required for "securities issued by smaller companies of recent origin," which could include many private placement issuers).
- The presence of "red flags" should alert the broker to the need for further inquiry.
- RN 10-22 stated that a member or associated person recommending a private placement should, at a minimum, conduct a reasonable investigation regarding:
  - The issuer and its management;
  - The business prospects of the issuer;
  - The assets held by or to be acquired by the issuer;
  - The claims being made; and
  - The intended use of proceeds of the offering.
- Since 2010, through its examinations and disciplinary actions, FINRA has observed other areas in which members' investigations into private placements could be strengthened.

FINRA Regulatory Notice 23-08 *(cont'd)*

- As part of a reasonable investigation of a private placement, members should also address, where relevant, the following:
  - **Regulatory and litigation history**, including the criminal, disciplinary, regulatory and litigation history of the issuer, its management and any affiliate that may be materially involved in the issuer's business, as well as the issuer's compliance with the bad actor provisions under SEC Rule 506(d)–(e).
  - **New material developments**, including events that are, or should be reasonably, known to the member during an offering (e.g., when there are ongoing legal proceedings or regulatory inquiries involving the issuer).
  - **Transactions or payments between an issuer and the issuer's affiliates involving offering proceeds**, including the terms of the transaction and whether an arrangement presents a material conflict of interest for the issuer (and, if so, the sufficiency of disclosure).
  - **Representations of past performance of the issuer, its sponsor or its manager** to identify any representations that may be misleading or exclusively selected based on positive results (or "cherry-picking"). This is particularly important when the representations pertain to specific prior issuances.

FINRA Regulatory Notice 23-08 *(cont'd)*

- Importantly, a reasonable investigation must **independently verify** an issuer's material representations and claims, particularly when the member or its associated persons are affiliated with the issuer or when red flags are present.
- A member's independent analysis of the offering should not rely solely upon representations made by the issuer or its affiliates.
- Information provided by third parties (e.g., attorneys and due diligence experts) should be reviewed with reasonable care, considering the independence, incentives and qualifications of the third party (particularly important with respect to third parties hired by the issuer).
- A member may demonstrate that it has conducted a reasonable, independent investigation by:
  - Documenting the inquiries, research, and analysis that the member conducted.
  - Obtaining additional information from an issuer to perform an independent analysis of issuer representations (e.g., if the PPM contains a representation concerning contracts or permits the issuer has in place/holds, a member should consider reviewing copies of such contracts/permits).
  - Critically analyzing third-party due diligence reports. Importantly, when a member encounters red flags through its own review, the member must address those issues prior to recommending the offering.

FINRA Regulatory Notice 23-08 *(cont'd)*

- **Customer-Specific Obligations**
  - Must have a sufficient understanding of the retail customer to properly evaluate whether the recommendation is in the best interest of the customer.
  - Should apply heightened scrutiny to whether a risky or complex product is in a retail customer's best interest (e.g., whether the retail customer has an identified, investor-specific trading objective that is consistent with the product's description in its offering documents and/or has the ability to withstand heightened risk of financial loss – see also *SEC Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Care Obligations (April 20, 2023) ("SEC Staff Bulletin")*).
  - For complex/risky products (including private placements), consider whether lower risk or less complex options can achieve the same investment objectives.

FINRA Regulatory Notice 23-08 *(cont'd)*

- **Other Reg BI Component Obligations**
  - *Disclosure Obligation*
    - Disclosure of conflicts of interests alone does not satisfy the obligation to act in the retail customer's best interest.
  - *Conflict of Interest Obligation*
    - There are conflicts inherent in any recommendation of securities based on the potential or actual receipt of compensation, revenue or other benefits.
    - Process to address conflicts of interest should not be merely a 'check-the-box' exercise, but a robust, ongoing process that is tailored to each conflict.
    - Conflicts may be of particular concern when members recommend private placements of securities issued by an affiliated company.
  - *Compliance Obligation*
    - Consider guidance in SEC Staff Bulletin concerning complex/risky products (e.g., consider developing procedures outlining the due diligence process for complex/risky products to ensure products are assessed by qualified and experienced personnel; require appropriate training and supervision to help personnel understand the features, risks and costs of such products; document process/reasoning behind particular recommendations).

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FINRA Regulatory Notice 23-08 *(cont'd)*

- **Certain Other Requirements Applicable to Private Placements**
  - Communications with the Public – FINRA Rule 2210
  - FINRA Filing Requirements – FINRA Rules 5122 and 5123
  - Supervision – FINRA Rule 3110
  - Private Securities Transactions – FINRA Rule 3280
- **Effective Practices - Offering-Specific Investigations**

  The process for conducting a reasonable investigation of a private placement should include attention to the unique facts and circumstances of the offering. This might include:

  - Reviewing offering terms to determine if they are reasonably structured for compliance with applicable rules.
  - Maintaining regular contact with the issuer to obtain updates on developments.
  - Applying a heightened analysis when recommending an investment that involves complex features or unique benefits to investors.
  - Maintaining an updated due diligence file (retaining records documenting both the process and results of the updated investigation).

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FINRA Regulatory Notice 23-08 *(cont'd)*

- **Effective Practices – Supervision of Reasonable Investigation Process**

  Procedures to maintain adequate supervision of a member's reasonable investigations under FINRA Rule 3110, or to meet the requirements of Reg BI's Compliance Obligation, might include:

  - Ensuring checklists are reasonably designed to address the private placement, filing/documentation requirements, assignment of staff responsible for performing functions/tasks, and evidence of supervisory approval for the reasonable investigation process.
  - Assigning responsibility for reasonable investigation and compliance with filing requirements to specific individual(s) or team(s) and conducting targeted, in-depth training.
  - Creating a system that alerts responsible individual(s)/supervisor(s) about upcoming and missed filing deadlines.
  - Requiring documentation of the process, completeness and results of a member's investigations and retention of documents collected through due diligence.
  - Implementing standards for the investigation process that specifically address certain types of offerings (e.g., specific guidelines for complex/risky offerings).
  - Ensuring that the member's sale of an offering does not precede the completion of its reasonable investigation.

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- Brian represents US and foreign private issuers, sponsors, and investment banks in registered and unregistered securities offerings, including:
  - Initial public offerings
  - Follow-on offerings
  - Private placements (including Rule 144A and PIPE transactions)
  - At-the-market offerings
  - Registered direct offerings
  - Liability management transactions
  - Preferred stock and debt offerings
- Brian serves clients on specialty finance, real estate and real estate investment trusts (REITs), business development companies (BDCs), and life sciences company deals. He also assists public company clients with ongoing securities law compliance requirements, listing standards of the major US stock exchanges, SEC public reporting obligations, shareholder-related disputes, and governance matters.

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- Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including IPOs and other public offerings and private placements of equity and debt securities.
- She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including tech, telecommunications, healthcare, financial institutions, REITs and consumer and specialty finance.

Additional resources

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