

EXPERT'S CORNER: WHY SELLING AGREEMENTS MATTER

Frederick Rosenberg

Perhaps the most overlooked document in cases involving Non-Conventional Investments (NCI) is the Selling Agreement, often called a “Placement Agreement.” It is the agreement between the Sponsor of an NCI and the broker-dealer selling the investment. This document defines the contractual conditions under which the broker-dealer will sell units to the public. Buried deep in Selling Agreements are terms, clauses, and agreements which can help investors in claims against both the selling broker-dealer and Sponsor.

Third-Party Beneficiaries: Every investor is a third-party (intended) beneficiary of the Selling Agreement.

FINRA Rules and Regulations: Virtually every Selling Agreement requires the broker-dealer to abide by FINRA Rules. As third-party beneficiaries of the Selling Agreement, investors can assert a violation of those rules as a contractual breach under the Selling Agreement without concern for the tiresome defense that a violation of FINRA Rules does not create a private cause of action.

Covenants, Representations and Warranties. Every Selling Agreement contains various representations, covenants, and warranties that the broker-dealer must agree to when offering these securities to the public, including compliance with the terms and conditions of the offering and all securities laws, conducting due diligence, use of sales materials, training of sales representatives, and vetting qualified investors.

Remedies for Breach: Every Selling Agreement has provisions assigning liability for breach of the agreement, including money damages, legal fees, and reimbursements. The provisions open the door for third-party claims against the Sponsor for its misrepresentations and its failure to adequately monitor compliance with the Selling Agreement. These terms often create an additional avenue for recovery where the broker-dealer which sold the investment is no longer operating.

A PPM is Not a Prospectus: Registered offerings made by Prospectus go through a detailed compliance checklist of disclosures, audits, and controls that typically must be updated and reported regularly and publicly. They typically are offered through syndications with an independent lead underwriter who conducts the due diligence and signs selling and syndicate participations. An NCI is generally sold through a Private Placement Memorandum (PPM).

PPM's however, rarely if ever, comply with the standards and reporting requirements of public offerings, and typically none are offered through an independent underwriter conducting due diligence. Absent an underwriter, the broker-dealer is responsible for due diligence and that requires specialized expertise often lacking internally. It is the Selling Agreement that stipulates due diligence obligations between the BD and the Sponsor.