

**EPISODE 289**

[INTRODUCTION]

**[00:00:00] ANNOUNCER:** Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

**[0:00:24.6] WS:** This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Amy Wan. Thanks for being on the show again, Amy.

**[0:00:31.9] AW:** Thank you for having me.

**[0:00:33.4] WS:** If you've been listening to the show for long at all, you've heard Amy's name before. I hope you have. She's been very generous with her time and her knowledge and has helped us with many episodes, covering many topics in the syndication business that you need to listen to if you're in this business. It's very important.

A little more about her; she's the Founder and CEO of Bootstrap Legal, which uses artificial intelligence to help draft real estate syndication legal documents faster and cheaper. She has authored LexisNexis, a private equity practice guide and was named one of 10 women to watch in legal technology by the American Bar Association Journal in 2014 and one of 18 Millennials changing legal tech and by law.com in 2018.

Amy, thank you again so much for your time. I'm always honored to have you on the show. These topics, especially today's topic – If you're listening to this, you are wondering about this right now. I know you are if you're in this business and it's such a hot topic. I get calls about this numerous times a week and I know Amy does too. Everybody's talking about it now, numerous

masterminds that I'm a part of have been talking about it and just calls all the time. That topic is raising capital and what that should look like when you're partnering with other operators and just what that should – how that should be structured, how it should not be structured, and Amy's going to help us understand that a little bit today.

Amy, thank you again. Give us a little bit about maybe an update about what's happening with you, or your business and let's dive right in.

**[0:02:02.0] AW:** Yeah. I mean, Bootstrap Legal is going well. We have had many clients come through since we opened our doors in 2017, so everything is great. The topic I want to talk about on this show today is capital rates. I'm aware that Mauricio did an episode on your show more than a couple shows ago talking about this topic. I want to make sure that we don't just do the basics that we really talk about what's going on in the industry today, because it's gotten to a strange inflection point, I think.

When I started in real estate syndication early on, there were definitely people going around raising capital, but not nearly as many today and not doing it the way they are today. I think it's just gotten to this really crazy bubble in the last maybe 12 to 18 months. There's just a lot of questionable activity going around. I think right now, it's time to really publicly talk about this. Things I've seen from my side is influencers, or real estate syndication marketers taking acquisition fees, or asset management fees, paying those out to capital raisers.

This new thing that I find very suspect, this deferred equity structure where it's, "Oh, I'm a part of the GP, but I'm not really in the GP. My name isn't on any of the investor decks or the PPM," and their slice of the GP is dependent on how much is raised. There's also been a practice of just I've got a deal. I'm going to let anyone go raise capital for this deal, and so that results in investors getting the same deal from multiple people who really are not the sponsor, right? Investors are left questioning like, "Well, who is the actual sponsor? This is very strange." I don't know. How have you seen other things that I haven't mentioned, Whitney?

**[0:04:05.2] WS:** I've seen many of those things you just said. I've had investors even – that have mentioned, "Well, I got this deal from the sponsor I've been working with for a long time, but then all of a sudden, I got the same deal from this other guy I just briefly met at this

conference.” Then they're trying to figure out, well, what's going on here? What is happening? I think it's leading, even are they LPs, the passive investors to really investigate what's happening here and who's actually doing the deal.

**[0:04:32.9] AW:** Yeah. I think LPs are definitely starting to get educated and get smarter and figure out what their rights are in all of this. Very, very briefly, and I don't want to go into the legalese too much, but the general rule for any capital – or which by the way is a terrible term for this role, right?

**[0:04:55.5] WS:** I have tried to delete that out of my vocabulary, but it's difficult. We've all been using that term so long, but it's like, my partner and I try to like, “Eh,” try to cut that out every time we say –

**[0:05:05.8] AW:** It's like, “Hello, SEC. Come look at me.” Everyone in this industry calls a capital raiser is really what we call a broker-dealer, right? I'm going to just read for a second. The federal activity-based definition of broker in section 3-4 of the Securities Exchange Act of 1934 is it's very straightforward, right? This is literally the definition. Broker: the term broker means any person engaged in the business of affecting transactions and securities for the account of others.

There's two really important parts of this definition. One is engaged in the business, right? Second is affecting transactions. Both those terms are very, very broadly interpreted by the SEC. It's pretty difficult to argue generally that a lot of these capital raisers are not engaged in the business when their activities are very directly related to capital raising and they are receiving compensation for those activities.

There's a very short clip, a speech that one of the commissioners of the SECC – of the SEC gave. I just wanted to read that to you guys real quick, because I think if you hear this, I think there's going to be a lot of red flags that go off in your mind. Generally, if you want to raise capital for others in the paid-transaction-based compensation, you have to be a broker dealer.

This is what that speech said: the test for broker dealer registration is broad and depends on various activities a person performs in one or more securities transactions. For example, some

factors – some example of activities or factors that might require registration as a broker dealer include marketing securities to investors, soliciting or negotiating securities transactions, or handling customer funds and securities.

This is the important part of the speech. The importance of each of these activities is heightened when there's also compensation that depends on the outcome, or size of the securities transaction. In other words, transaction-based compensation also referred to as “a salesman's stake in securities transaction.” The SEC and SEC staff have long viewed receipt of transaction-based compensation as a hallmark of being a broker.

This makes sense to me as the broker regulatory structure is built at least in large part around managing the conflict of interest arising from a broker acting as a security salesman, as compared to investment advisor, which traditionally acts as a fiduciary and which should not have that type of conflict of interest.

Okay, so transaction-based conversation and really the way the industry thinks that they're getting around all these is that there's something called the 3A4-1 issuer exemption, which basically states that hey, if you are an officer, or a director of the issuer of the security, in this industry that would mean the sponsor, or the managing entity, right? Then it is okay to be – to go market these securities and be paid transaction-based compensation. That's true. There is an issuer exemption.

The way people are dealing with this issuer exemption is not kosher. I talked earlier about this whole deferred equity structure, and let me explain very quickly what that generally looks like. The sponsor will go to the capital raisers and say, “Hey, you're going to be part of the GP. You're going to be part of the issuer. Thus, you could be paid transaction-based compensation for raising capital and everything's fine.”

Then sometimes they will have a separate agreement with the capital raiser that says, “Okay, and as compensation for other services like investor relations, your slice of the GP is going to be dependent on how much capital you bring to the table.” In some cases, there's even an algorithm of exactly how much of the GP they get. You bring in a million dollars, well that's one-

fourth of the overall raise, so you get exactly this much, right? That is the definition of transaction-based compensation.

Remember that these terms are broadly construed, which means it's not just money. You can get cash, that's compensation. You can get feel. You can get Bitcoin. You can get equity. Many things count as compensation. It doesn't matter if it's cash from the acquisition fee, cash from the asset management fee, cash from whatever fee, that's all compensation, okay? That's number one.

Number two, the point I want to make is if you are not in the PPM and you are not in the investor deck and you're one of these dozens of capital raisers who you maybe sign this agreement and they shuffle you into this LLC and that LLC is named on the PPM, but the people behind it are not, that's problematic, right, for a number of reasons. You may be thinking, "Well, but that's not the case, because I'm part of the GP, but you're not." right? Because if you raise zero dollars, you are not part of the GP. This deferred equity structure thing is it's pretty laughable to me, because it's clearly just I think an attempt to get around the rules, a very unsuccessful attempt.

Whitney, you and I were talking yesterday, but the rule of thumb I think in not just this area of law, but many areas of law especially securities laws. Because we were all trying to get around securities laws, is if it walks like a duck and it quacks like a duck and it swims like a duck, it's probably a duck, right? If you are going head-over-heels trying to create crazy, complex loopholes so that you can get around the broker dealer rule, it doesn't matter what form it takes.

There's no algorithm. There is no formula. There's no if I do this, then it will not – we're not paying transaction-based compensation, you don't have to go just as a broker dealer. It is simply if it looks like transaction-based compensation, if it looks like you're doing broker dealer activities, you're probably doing broker dealer activities.

**[0:12:05.5] WS:** A minute ago, you mentioned if you're – if you do not raise any money, then you're not going to be paid anything. I mean, that right there seems a pretty easy way to just figure out if you're doing this properly or not. Are you going to be paid if you do not bring any capital to the deal?

**[0:12:22.1] AW:** Yeah, definitely. If you are going to be paid something regardless of whether you bring investors to the dealer, then that's a different question, right? I think there are ways of doing that, but at the same time, the devil's in the details, because a lot of it is about how you do it. I think in the past – and I want to say that the real estate syndication industry is not alone, right? I think in many different industries right now, people are becoming increasingly creative around this restriction and it's gotten to the point where even last week there was a thread on the ABA, the American Bar Association, where a lot of securities attorneys were talking about the crazy structures that we're seeing.

There was one specific instance people talked about in which case, the issuer, which it was not a real estate company. I think it was probably a tech company. They were like, "Well, we are going to gift some equity to this capital raiser and their job is going to be making introductions and start doing the raise and fund raising and all that stuff." They're going to get that capital no matter what, but their logic was well, the success of the company is dependent on whether or not we raise. If we are able to raise, then afterwards, that particular deal included a buyback option.

The way they were going to compensate the capital raiser was, "Okay, well if we raise, we will buy back or equity, you will end up getting cash," and that's how you are going to get paid. Pretty much every single attorney on the thread was like, "No, this is illegal." Not only is it legal, there's other things you have to think about too.

Let's talk about for one second if you are a capital raiser. If you sign one of these agreements, the agreement in the vast majority of states is not going to be any good. The agreement will be void, right? You will not be owed anything. The reason why you would not be owed anything is because there's a general concept in law where basically if you do anything illegal, so you make some agreement that is in violation of federal and state laws that are deemed against public policy, they are basically unenforceable, right? Not only that, the unlawful sale gives investors rescission rights against the issuer.

Rescission basically means anytime during the deal, investors are entitled to all their money back. That, plus certain states have other laws that you should be aware of, right? For example, California has a very draconian law. The investor can actually require the unregistered broker,

so the capital raiser to repurchase the unlawfully sold securities. You the capital raiser, if you get a complaint from an investor, you have to pony up the cash to buy back all those securities from that investor. If you raised a lot, you're going to have to buy back a lot.

I also want to talk very quickly about how the courts view this activity, because whenever you're dealing with securities laws, right? You have a regulatory – Okay, actually, there's three things to think about. You have the SEC, which is the federal regulatory agency. Then you have state regulators and different states work different ways, right? For example, Maryland is very aggressive because their version of their state SEC falls under the attorney general's office. They tend to be one of the more aggressive states.

Then you have something that we call the plaintiff's bar, right? There's many different types of lawyers; there's transactional attorneys, which I am, which they help you do your deal, right? But they don't go to court. There are litigation attorneys, where all they do is sue people all day long, or defend their clients all day long and they go to court.

All the litigation attorneys, there's two flavors; one type of litigation attorney is the type of person who generally defends a client, usually corporations, or things of that sort. The other type is what we call the plaintiff's bar. The plaintiff's bar is exactly what it sounds like. It's the people who go and help someone sue, right? There are some plaintiff's bar attorneys who do not take fees upfront. They take contingency fees, which means that they get paid only if they recover something from the case.

**[0:17:09.3] WS:** They're very motivated.

**[0:17:13.5] AW:** I used to explain this to people back in the ICO days. If you get a letter from the SEC, the SEC it's a civil servant, probably someone who lives in Washington DC or what other regional offices, they go to work 9 to 5, they're trying to do their public duty, they're not malicious people. They're just trying to enforce the law and do what they think is right. If you cooperate, generally, your life is not going to go down the gutter.

The plaintiff's bar is another breed of personality. They're not bad people, right? It's just that they tend to have a bulldog personality. If you cooperate with them, it will not make your life easier.

They're never going to walk away until they get their money, because they've already invested work, right? Typically, you're looking at something like a 25%, 30% contingency fee. They are motivated to recover as much as possible for their claim, because that's how they get paid.

Furthermore, if you take it to a court, while the court might look the actual capital raising activities more closely than the SEC might, the SEC could not be clearer in its enforcement position and defending an enforcement action through the core appellate process to get a court's review of the facts and circumstances of the case. This usually takes years and tens if not hundreds of thousands of dollars of attorney fees to reach a conclusion. Without any assurance of the outcome, trust me, the SEC is very highly motivated to defend its long-held position in court about what our broker-dealer activities, okay. That's all one topic.

The other topic I wanted to say, there's so much to talk about with this topic. There's so many ways to divide and conquer it. Some folks think that, "Wow, it's okay, because the offerings in this state and I'm just going to go to investors in this state." They think what they're dealing with is what we call in intrastate offering, right? You're only dealing with people in one state and thus, you fall under a state exemption, not a federal exemption.

Generally, that is correct. Except for the fact that every state has their own broker-dealer exemptions. A lot of them also take a very broad view of all these types of broker-dealer activities. The definition of a broker-doer, or a dealer tracks – tends to track very, very closely with the federal definition.

There are a few states with no exemptions for finders and they – but they also impose conditions on their exemptions for state find your filings, or finder fees. States are more likely to identify and take enforcement actions than the SEC, because they're closer to the investor, right? They are also very highly motivated to defend their position on what constitutes a broker-dealer. If you're relying on an interesting exemption, know that state laws exist as well.

**[0:20:47.2] WS:** That's a lot to digest, that's for sure. It's great information though. You mentioned very early on about they were – they were not doing it the way then that we are today. I just wondered, can you elaborate on that a little bit? What's changed this and what – or where do you see this going?

**[0:21:07.4] AW:** The way people were doing this before this recent explosion looked a lot more like they were actually part of the GP, they were actually a part of the sponsor, right? Even though one of their duties was raising capital, it was not their sole duty. They didn't just tack on, "Oh, you're going to raise capital and do investor relations."

I had a client ask me a couple weeks ago, "Okay, so if I engage one of these capital raisers and I have them also do investor relations, is that okay? Is that enough?" I was like, "No. As an attorney, I would never tell you that's okay or that's enough." You want them to be truly a part of the sponsor. They're not just relegated to this one little thing that they do and then for the next five to seven year hold period of the project, they sit on their butts, right? No. They have to actually be engaged.

Typically, what these deals used to look like was there were documents, the PPM, the investor deck where these people were named as part of the sponsor. These people would get a slice of the GP, but it was not determined by some algorithm. It was like, "Okay, we're going to give you 5%. We're going to give you 10%. Whatever." If that person brought in zero dollars, then that person brought in zero dollars, but that's it. You're not going to take that slice of the GP away from them.

They had many other duties aside from raising capital, or investor relations, right? Maybe it's interfacing with the CPA, helping get K1s issued, maybe it's dealing with legal, maybe it's helping due diligence with the property, maybe it's coordinating with the property management. There's a number of things – there's so many things you could do as part of the sponsor, right, other than just raising capital.

While I'm reluctant to say what I just described is a foolproof way of being able to do business as a capital raiser, it comes back down to my duck analogy, right? If I were to take a step back as the reasonable person, if I'm going to go sit on a jury and I have no experience with investments, or capital raising, or anything like that and I had to sit in court and listen to people describe their activities as a capital raiser and someone then told me the definition of a broker-dealer and how to interpret it, would I as the reasonable person think this sounds more like a

capital raising scheme, or would I think, “Hey, it sounds like they're truly a part of this general partnership.” That's what it comes down to.

There's no magical voting structure right. There's no magical like, “Okay, well if you do this, this and this duty, you're good,” right? Unfortunately, you have to look at the facts and circumstances.

**[0:24:19.1] WS:** There's not a number of capital raisers. There's not a yeah, how much of anything. It's really using some common sense it seems like. Making sure that when you're part of the general partnership that it's - if your only duty is to raise capital, then there may be a problem.

**[0:24:37.7] AW:** Yes. There's definitely a risk towards having more people as GPs in the deal, as opposed to having fewer, but that's entirely different topic in and of itself that I'm hoping to cover on the next show.

**[0:24:51.8] WS:** Okay. Yeah, we don't have a whole lot of time left, but that would be great to talk about that as well, because I know this topic is extremely talked about right now. Amy, we are about out of time. Anything else you want to leave us with on this topic that – you and I did talk yesterday and we both talked about any calls we're getting about this specific topic, but anything else you want to leave us with before we have to go?

**[0:25:16.8] AW:** If you don't listen to the next episode that you do, I just want to leave you with this, which is the people that you partner with in business, especially in the securities industry is incredibly important. We don't have time to go into that topic today, but I'll just leave you with that.

**[0:25:34.5] WS:** Okay. I'll say, that can haunt you forever, right? I mean, the people you're partnering with today and somebody else makes a mistake, it can affect you throughout your syndication career.

**[0:25:44.7] AW:** Exactly. Yeah.

**[0:25:47.1] WS:** All right, Amy. Thank you so much. Before we go, tell people how do you like to give back?

**[0:25:53.3] AW:** Oh, to give back. Well, somehow I feel like I end up doing a lot of free legal work, not in the real estate syndication space, but I'm really only good in my area of law specifically. I feel I'm a Rolodex for people who are trying to find different types of attorneys and I'm generally pretty good at tracking down attorneys who work on very specific things. I love working with specialists, not generalists. I do spend a lot of time doing that these days.

**[0:26:24.2] WS:** Nice. Okay. I know you've helped me a lot and you're helping the listeners a lot as well. We are very grateful for your time. Tell them how they can get in touch with you.

**[0:26:32.7] AW:** Yeah, sure. The best way to get in touch with me these days is just go on my website and request a consultation. It's bootstraplegal.com. You can also e-mail me at amy@bootstraplegal.com. I don't use LinkedIn, or Twitter, or the other social media so much these days, because I'm just getting a lot of spam, so yeah.

**[0:26:52.4] WS:** All right. Thank you again, Amy.

**[0:26:54.4] AW:** Thanks.

[END OF INTERVIEW]

**[0:26:55.2] WS:** Don't go yet. Thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real Estate Syndication Show on Facebook, so you can connect with me and we can also receive feedback and your questions there that you want me to answer on the show. Subscribe too, so you can get the latest episodes.

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[OUTRO]

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