EPISODE 322

[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]

[0:00:24.4] 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.

[0:00:32.7] AW: Thanks so much for having me.

[0:00:34.1] WS: It's always a pleasure. If you're a frequent listener, you've heard Amy's name many times. She's been very gracious and generous with her time and shared lots of knowledge and wisdom with us in this industry and how we can make sure we're staying out of trouble and doing this legal as possible. Little 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. She 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 by law.com in 2018. Amy, thank you again for your time and you're a frequent guest now and I'm grateful, because it's great to have I mean, somebody like yourself that can come back and just numerous topics.

There's so many questions I get also that people ask me even through the Facebook group, or just at a conference assuming that I know and I'm – I'm not an attorney, but this is what I think. It's great to have somebody like yourself. Thank you again.

[0:01:37.5] AW: Yeah, of course. It's super helpful for me too, because sometimes I'm like, "Oh, I don't have anything else to talk about." Then something will come up with a client and I'm like, and you have to really explain it to them and I'm like, "Oh, maybe I should talk about this on Whitney's show, so everyone knows."

[0:01:53.4] WS: Yeah, that's awesome. Well, thank you again. Today, tell us a little bit – I know, you and I briefly discussed it, but tell us a little bit about our topic today and then let's jump in.

[0:02:02.1] AW: Yeah, sure. Today, we're talking about material disclosures, right? The consequences of what happens if you don't disclose everything materials and how it all works in practical applications. Just jumping in, there are certain things that you have to disclose to your investors on every deal that you do. Those details include things about the offering, or the property itself, right? Like, "Oh, this place used to be a meth lab, or whatever."

Usually, I find that disclosing things about the property is not that much of an issue amongst clients, but then when we get into personal disclosures, that's when people feel very comfortable, because you do have to disclose things about yourself and your past as a sponsor, right? This includes bankruptcies, any criminal proceedings, any current litigation that you're in, any current, or previous enforcement actions, or investigations by the SEC, or state securities regulators, anything of that sort, right?

It does go on for a long time. By the way, when I say just – when I say bankruptcy, this includes personal and business bankruptcy. We're covering the entire gamut here. When it comes to any of this, there's nothing in the regulation itself most of the time that says, okay, for X specific event, you must write a paragraph in the PPM that talks about this.

Usually, most of this falls under what we call materiality provision, which is you have to disclose whatever is material to the offering and what is material? There's no hard and fast rule, but because there is a lot of securities litigation that goes on all the time, especially in the real

estate investment space, 99% of securities attorneys are going to be more conservative than less conservative.

When you ask, “Oh, is something material?” What you're really asking is okay, would the reasonable investor wish they knew this before investing in the deal, right? That's really what you're asking. We're not asking, do you the sponsor think it's important? We're asking what a judge or a jury person feel like they would have wanted to know this prior to investing the offering. I want to give you guys little anecdote about why this is important, right?

[0:04:47.0] WS: Can I back up just one second?

[0:04:47.9] AW: Yeah.

[0:04:49.0] WS: Material disclosures, is this going to be a specific part of the PPM that's going to list this, or have these items that should be in there? Or is it very standard? I mean, I've looked at many PPMs, but obviously a 100-plus pages. I can't remember exactly where that is, or even if I've read this before. Where's this going to be at?

[0:05:09.6] AW: Right. There's no specific place in the PPM where it's going to show up, but where you probably want to look, right, is when it comes to material disclosures about the sponsor themselves, it's probably going to show up wherever they talk about the sponsor. Either in the deck where they have their biographies, or the part of the PPM where it lists who are the sponsors and a little bit about their background. Then disclosures about the risks of the investment itself is there's usually a whole section around that.

[0:05:43.2] WS: Right. I can see definitely the risks around the property, or like you said, it used to be a meth lab, or things like that that you have to discuss. I can't imagine a sponsor putting somewhere about previous bankruptcy around his bio.

[0:05:58.4] AW: That's why they don't write it. That's why rewrite it. Then I have to spend half an hour, an hour, sometimes many, many sessions with a client to explain to them how important it is to have this language in the PPM. It’s why I'm on this show.

[0:06:15.1] WS: That's right. That's right. All right, so go right ahead.

[0:06:18.5] AW: Yeah, sure. Bankruptcy's your average securities attorney is going to want to disclose bankruptcies for at least the past 10 years, sometimes more. There's also an important thing, when we ask about materiality, this important thing where you have to put in details that are important in assessing the integrity of the issuer. Basically, I want to give you a little anecdote. I had a client recently in the past couple months where they were partnering with someone else. They're both principals, part of the sponsor. It turns out that someone else had something happened to them 11 years ago with the SEC.

That thing that happened 11 years ago seems like it wasn't even that person's fault. It was they had a bad business partner 11 years ago, and so the SEC came along, right? Now because of something that someone else did 11 years ago, this guy now had to make sure that he disclosed what happened to his business partner in the PPM. They really didn't want to do that. We had to have a lot of come-to-Jesus talks. Basically, had to go over what are all the ramifications if you don't disclose, right?

This particular thing did call into question the integrity of the issuer. What happens if you don't disclose? You're potentially leaving out something material for the securities attorney. That's really bad, because that's your malpractice insurance on the line. For the sponsor, the way I explain is there's two different things that you have to worry about when it comes to getting in trouble with the law, right? One is the regulators, and so there's federal regulators, which is the SEC and then there's state regulators.

Regulators have limited capacity to go after people. They will not go after everyone. That's regulatory risk. There's also something that we call litigation risk and that is when your investors go and hire a bulldog attorney to come after you and make your life miserable for several years, if not more, right?

Litigation risk is often what we're talking about when we're talking about material disclosures, because if investor comes back and complains that you did not disclose this thing that you thought was this one little thing, they actually have a right of rescission for the entire life of the deal, whether they've been paid back or not. If the deal has gone south, they still may have that

right of rescission, right? Like we said in last show in some states, you would have to buy back their securities, even if the money is gone, like you don't have the money anymore, you'll be on the hook for that.

[0:09:21.2] WS: This could happen for the length of the deal you said, so the life of this specific project.

[0:09:26.1] AW: Yes, exactly. Now that's where it starts. Then it gets worse after that, right? Because once you're in current litigation on a deal, then any project that you do afterwards, you have to disclose that current litigation. Guess what? Now it's material, because you've left out something that caused them to question your integrity, right? Because you made a decision not to disclose something on a previous deal.

It's this cascade of all these different thing. Now, anyone that you want to partner with has to basically disclose on the PPM and say they're probably – they might be less inclined to partner with you, because it's just not a good look, right? This is why I always say that around these issues, you want to be very, very careful.

Because once you make a misstep, it can follow you around for the rest of your syndication career, right? It's much harder for you to look good doing offering from here on out. Even if you get out of the real estate syndication business, it's much harder for you to be a director or officer of any organization that is raising capital, because they're going to have to disclose it.

[0:10:49.8] WS: I wonder about how when we're partnering with numerous people on a deal, you mentioned this person's partner that they had many years ago had an issue and obviously, it affected them now as well. Actually, I wanted to mention show 319, WS319 was our previous show, which I would encourage people to go back and listen to where Amy talked about ways that people are using “capital raisers” and how they're paying them and how it's not legal and all those things that I would encourage you to go back and listen to. Very important show for our industry right now.

When we're partnering with all those people that most of them have never met each other, most of them don't know who – there maybe 20, some of these opportunities or some of these deals.

If one of those people have had an issue like this, or bankruptcy, or they've had other litigation, or whatever, or some type of enforcement actions by the SEC and I've never met that individual, how does that affect me say on the deal, or deals going forward?

[0:11:47.9] AW: Right. The liability of all your business partners is your liability, right? The more people you have in a deal, the higher risk there is around this stuff, because if you've got 20 people in on a deal, which quite frankly is a lot, the chances that you are going to be able to whoever is organizing all of this is going to be able to go and figure out like, is there stuff we have to disclose about every single person?

I mean, it's so much harder to catch, right? Even more than that, anything that those other people are running around and doing on behalf of the offering suddenly becomes your liability. If they don't know anything about securities laws and you have 5-6B offering and they go out and make a public YouTube video, guess what? That's general solicitation. That's on you now, right? You would have to do a lot of quick fixes to the offering to save it, I would say. If you guys didn't catch it and the offering closed, well A, there's still that right of rescission for investors depending on what was said or not said, or done.

Then B, if someone complains about in the future, someone sues about in the future, guess what? They're going to sue the manager, which is all these dozen, or 20 people, which is all the business partners involved. It's just a huge cascade effect. You want to always be very careful about who you partner with, because everything that they do is also on you and affects your deals in the future.

[0:13:33.5] WS: It's a big deal. Then we understand that, right?

[0:13:37.2] AW: Yeah.

[0:13:37.9] WS: Wow. Okay. Now we know that we better disclose some of these things, or bankruptcy – even if it's personal. You said, it doesn't have to be just something business-related, or something related to the SEC, or some type of – something or a estate regulator on our business. Even if it was something personal, anything else personal other than bankruptcies that we need to be aware of that must be in there?

[0:13:57.7] AW: The biggest thing would just be that if there has ever been enforcement action, or if the SEC, or any state regulator has named you as a bad actor, and so I'll say in many in cases, that limits your ability to raise capital in the future. In terms of being a bad actor, you would know if you've been named a bad actor, because you've probably been through a lot with the SEC. If you haven't heard from them, you're likely not a bad actor.

I talked about some of the litigation risk. In terms of what the SEC can come back and get you for, right? They can come back and get you for disgorgement of profits, so everything that you profited. They can order you to pay investors back everything. As with every SEC violation, there's a litany of possible punishment, including penalty, fines, criminal charges, jail time. They could label you as a bad actor. Those are all places that you just don't want to go there. Your life will be so much easier if you don't go there.

[0:15:05.0] WS: In a big way, right? Or you're going to pick a new career most likely, if these things have happened, right?

[0:15:10.4] AW: Yes. In that new career, you're going to have difficulty if you want to be an executive, or director, or officer of that organization.

[0:15:20.1] WS: Okay. Anything else about material disclosures, Amy, that we need to be aware of?

[0:15:24.5] AW: I would say that's pretty much it. The other thing is don't be one of those people where if this has happened to you, you jump from securities attorney to securities attorney to find someone who will be going to represent your deal without either making that disclosure, or to do the offering in general in case other attorneys won't do it for you. It's not a good look for you. It puts a lot of risk on the attorney. We hate it.

[0:15:56.4] WS: Yeah. You probably recognize somebody that's jumping around pretty quickly anyway, or probably about some of the questions that they're asking, you probably understand pretty quick if they're trying to get away without disclosing something.

[0:16:08.4] AW: You can, but some people I think are also – they can be very sneaky about it, right? They learn from their first, or the first couple securities attorneys, but they're supposed to, or what questions they'll get asked. By the time they get to you, they know how to answer those questions in a way that is less suspicious.

[0:16:29.3] WS: I understand. I mean, I really appreciate you telling us about the material disclosures, because I feel like the way that people are partnering these days and we covered that on the last show, that this is more important than ever before.

[0:16:41.8] AW: Yes, definitely. I will say that there's no magic number of how many people is the right number of people to partner with, so that there's less risk, or that there's – so that you're not breaking broker dealer laws. What I will say is all of this is a very fact-based analysis, it's very case-by-case. The more conservative approach you take as a sponsor, in terms of security laws, I think the better off you're probably going to be.

[0:17:11.6] WS: Is there a way that we can check others, see if they've ever been labeled as a bad actor or something like that?

[0:17:18.4] AW: You can. I mean, third-party verification services that will – that you can go out and hire to do this for you. A lot of people don't want to spend the money. Typically, your law firm that you're working with is going to either make you guys sign something, or make you guys certify something in your intake where you have to disclose, are you in current litigation? Have you had any bankruptcies? All of that stuff. That's typically the way we catch this stuff. If someone makes a misrepresentation to the attorney well, then they're committing fraud.

[0:17:59.4] WS: Okay. Then it's on them and not you as their attorney?

[0:18:02.8] AW: Yes, exactly, right? Because we can really just go off the information that we're working with.

[0:18:08.1] WS: All right, Amy. Well, it's very important topic today and I appreciate you elaborating on these disclosures that we need to know that we have to put out there. I mean, it's important for investors to know as well and I hear of more passive investors now doing

background checks and credit checks and things like that, where they're going to catch maybe some of these things. If they know to do this, they would probably would compare that to your PPM and see if you've disclosed these things or not.

I've heard of some passive investors who are have checked backgrounds and they're very surprised of what they find. Even if it's many years ago, then they go to ask the operator, or something about what happened. Sometimes it's not a big deal, but then other times, they're very thankful that they checked. Tell us though, before we have to go, how do you like to give back?

[0:18:56.9] AW: Yeah. I was actually thinking about this question the other day when you asked it of me and talked to my husband. I was like, I'm a parent. I feel I'm helping to raise the next generation. I was like, two years ago when I had my – when I got pregnant having my kid, I actually removed myself from a lot of the boards I was on. I feel parenting, at least in this phase right now is how I do that, because it is all-consuming.

[0:19:28.5] WS: I completely understand. Completely understand. That's awesome, Amy. Tell the listeners how they can get in touch with you.

[0:19:36.1] AW: Sure. My website is bootstraplegal.com and you can always pick a consultation there. Or just e-mail me at amy@bootstraplegal.com. I'm not so much on LinkedIn and Twitter and all those things these days, because of all its bad messages. E-mail and my website are the best way to contact me.

[0:19:58.7] WS: Amy, thank you again. We will talk to all the listeners tomorrow.

[0:20:02.3] AW: Okay, great. Thanks.

[END OF INTERVIEW]

[0:20:03.8] 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

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[OUTRO]

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