Non-Financial Disclosures Required in Offerings – Bruce E. Methven

One basic rule in securities offerings is that in the disclosure document the offeror must disclose everything that a potential investor would reasonably want to know before investing. ("Disclosure document" basically means the private placement memorandum, which is also known as the prospectus, offering circular, etc.) This is often called the anti-fraud rule.

The consequence is that is that if there is any doubt about certain information, it should be disclosed. An offeror can only get into trouble by disclosing too little, not by disclosing too much. While disclosure of significant negative information has to be made, the offeror can also provide information about how it plans to deal with the situation or how the information is not as negative as it might first seem.

The table of contents for Part II of SEC Form 1-A provides a handy list of the information to be disclosed, which is information about:

The Company
Risk Factors
Business and Properties
Offering Price Factors
Use of Proceeds
Capitalization
Description of Securities
Plan of Distribution [how the offering will be made]
Dividends, Distributions and Redemptions
Officers and Key Personnel of the Company
Directors of the Company
Principal Stockholders
Management Relationships, Transactions and Remuneration
Litigation
Federal Tax Aspects
Miscellaneous Factors
Financial Statements
Managements Discussion and Analysis of Certain Relevant Factors

Of course, additional items that are not covered by this list may still need to be disclosed. In addition, some types of offerings have specific disclosures that must be made.

Risk factors are crucial and are often divided into general risks (e.g., the industry may have a downturn) and risks specific to the company or offering (e.g., the offeror has a competitor or the head of the company would be difficult to replace). It's hard to over-emphasize the importance of the risk section, and significant time and care need to be devoted to it. In addition to informing potential investors, the risk section helps provide the offeror with protection from investor claims if the ventures turns out badly.

Form 1-A indicates that past **bankruptcies of officers, directors and key personnel** of the company (as well as the company itself) must be disclosed. The basic disclosure rule means that the same is true with past securities laws violations, license discipline, felony convictions, and at least some litigation. Sometimes, this may lead to certain individuals not being officers, directors or key personnel. (In addition, the "bad boy" rules that cover key personnel who in the past were sanctioned for securities violations may also impose additional disclosure requirements or prevent certain types of offerings from being made.)

Regarding **principal shareholders**, Form 1-A indicates that disclosure should be made of owners who own directly or indirectly 10% or more of the outstanding common and preferred stock or who would reach that percentage if any convertible notes, etc. were converted into stock.

With respect to **tax consequences**, although an offeror may provide general tax comments, the potential investors should be told that the company is not offering tax advice and that the potential investor should consult his/her/its own tax advisor with respect to tax consequences.

One item that is not expressly mentioned in the list above but that is crucial is the **exit strategy**. In other words, the way it is expected that the investors ultimately get their money out of the investment. (It may be by going public, selling the company, buyout of the investments by the company, etc. – or perhaps there is no exit plan other than the investors getting their money back and more.)

Financial disclosures and how the securities are structured will be covered in future blog posts.

Bruce E Methven

For more information on securities laws, head to Background on the Securities Laws: http://thecaliforniasecuritiesattorneys.com/?page_id=41

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