

Investment Law

Quarterly Update

THE LAW OFFICES OF BORTON PETRINI, LLP

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A PRIMER ON INVESTMENT REGULATIONS: MANY LAWS REGULATE COMPANIES ISSUING STOCKS AND BONDS TO THE PUBLIC AND THE PEOPLE WHO DO THE SELLING

by Roger Parkinson

General Kinds of Regulation of Investments

There is an elaborate web of laws from both federal and state governments that regulate businesses that take money from the public for investing. Still more laws regulate people who sell stocks and bonds to the public. There are also regulations by private groups over their members. Examples are the New York Stock Exchange and National Association of Securities Dealers (NASD). As with the Internal Revenue Code, the average person has no chance of understanding them.

There are similar regulations over commodities futures, too, but they are on a lesser scale. Regulation of real estate investments is for the most part by the state government rather than federal. They are also on a smaller scale than for stocks and bonds because real estate is not usually mass-marketed. When there is mass-marketing of real estate interests, the regulation is often by the same agencies that regulate stocks and bonds.

What Investment Regulations Do

The effect of the many regulations on investments is to force large amounts of information to investors and to would-be investors so that they can best choose

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Roger A. Parkinson



Roger A. Parkinson is a senior attorney in the Bakersfield office of Borton Petrini, LLP, with long experience in business transactions and litigation. He received his B.A. from Stanford. He was awarded an L.L.B. from Stanford Law School, where he served on the board of editors of Stanford Law Review, then elected for the California Supreme Court.

He next practiced with the San Francisco firm of Landels, Weigel & Ripley, specializing in trade regulation (antitrust and pricing law), intellectual property and title insurance. Then he became corporate secretary and counsel to the publicly traded Insurance Securities Incorporated, a large mutual fund and insurance operation with subsidiary insurance companies. There he dealt extensively with federal and state securities laws.

At the Los Angeles branch of Long & Levit, he became a member and later managing partner. He remained managing partner of its successor, Parkinson, Wolf, Lazar & Leo and then with Parkinson & Martinsen. He was counsel to the Western Stock Transfer Association. He has participated in numerous securities, commodities and real estate investment cases, including class actions. He has long been a NASD arbitrator.

After further practice in Silicon Valley, where he was on the executive committee of the Business Section of the Santa Clara County Bar Association, he joined Borton Petrini, LLP. He continues practicing in a variety of business transactions and disputes.

WHAT ABOUT WHEN YOUR FELLOW CLUB MEMBER WANTS YOUR INVESTMENT IN HIS COMPANY

by Roger Parkinson

Al, a fellow club member, invites you to invest in his small business. Assuming you are interested, having a general knowledge about the different kinds of investment regulations (see the other article in this newsletter) will not be enough of what you need to cope with this decision. To be a wise investor, you really ought to see a lawyer if the proposed amount is over \$2,000.

To buy stocks or bonds of companies on the New York Stock Exchange, you would not expect to use a lawyer except for any estate planning that might be involved (e.g., how to take title). However, investing in a small business is quite different. While the investment results could be much better, they can also be much worse.

To begin with, an experienced business lawyer can quickly see if Al's company is following all the requirements for giving you **full disclosure**. You do not know what that would be, and Al probably does not either, except he wants to make the sale. In this regard, the attorney-client privilege is a gold mine for you. The business lawyer will never tell anyone what you two discussed, and no one can ever get it out of him any other way. You might otherwise miss some simple problem that could bite you in the leg later.

People who take proper care of their financial affairs often consult their lawyer before documenting a transaction they enter into. It is nothing to be ashamed of or any indication that you do not trust Al. For example, if what Al wants (or what your lawyer advises it should be) is a loan, the paperwork Al proposes may not include a note properly favorable to you. What is more, it is up to you whether you mention to Al that you conferred with your lawyer. You have the choice whether you even mention to Al that the changes you want came from consulting your lawyer.

Be mindful, even if Al does everything right and gives you the required full disclosure, you can still lose money on the investment. Getting him to tow the mark helps but is no guarantee. In my experience, just letting Al know that your lawyer is helping you decide can help get you the right information. It signals your determination that you must not be harmed.

What else can your lawyer do effectively in this situation?

For one thing, he can ghost what you might write to Al's company to maximize your record on what has happened.

If you seek to protect yourself, are you being so aggressive with Al that you will lose a great investment

opportunity? This is a key area **if** the opportunity is clearly sound other than protecting you. Al is probably taking risks, too, in the venture. Odd as it seems, unless Al is represented by cooperative counsel, he could be edgy that you are so concerned about your own risk.

Al may have squared with all the necessary regulations for his company to make a proposal to you, but they might have omitted showing you what they should have. For your protection, this information needs to be found out.

In our capitalist system, you alone end up deciding whether to invest in Al's company, but this is one of the better places to get a boost from your business lawyer.

Use the **attorney-client privilege** in this kind of situation. Nobody can ever find out what you and your lawyer discussed, or what criticism there was of Al's firm. You get the further option to tell Al your lawyer advised you or not, and to pass on recommendations of your lawyer either as his or as your own. You can also use the lawyer to ghost letters for you or assist in writing them.

Borton Petrini, LLP has many knowledgeable investment and business attorneys who can help you make your investment decisions.



THE BORTON PETRINI BUSINESS HOUR

IMPROVE YOUR INVESTMENT SAVVY WITH THE BORTON PETRINI BUSINESS HOUR

You can get a wealth of free information on legal aspects of business and business investments by listening to the Borton Petrini Business Hour on KERN 1410 AM Radio in Bakersfield every Sunday evening at 6:00 p.m.

In these broadcasts, there is commentary by experienced lawyers from Borton Petrini, LLP intermixed with business people and other professionals whose careers are in the areas under discussion.

The Firm intends to keep up this community service for some time to come, to help upgrade knowledge in areas likely to infuse business know-how in the community.

To see a list of upcoming broadcasts, visit our website: www.bortonpetrini.com.

A PRIMER ON INVESTMENT REGULATIONS

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where to invest. The desired affect is called **full disclosure** as a legal objective. That legal objective leaves the investor free to lose his shirt on an investment as long as he, or the marketplace, received a full amount of information about the company's finances and problems.

Fully Disclosed But Broke

The would-be investor should know some critical flaws in full disclosure as the guide and end. One is that the most important thing to know, *the future*, is not capable of being disclosed. No one knows it. Instead, the company or mutual fund may give exquisite history of stock price over time, but that cannot predict what might happen to the company in the future. In the investment business, how a company has been doing in its sales and profits is called **fundamentals**. Most disclosure deals with such fundamentals. What else cannot be disclosed, though, is what other investors will likely think of how the stock price is going to go, which drives a free market. Also critical, is how the market will do as a whole, which has little to do with the fundamentals of any one company. A rising tide lifts all boats.

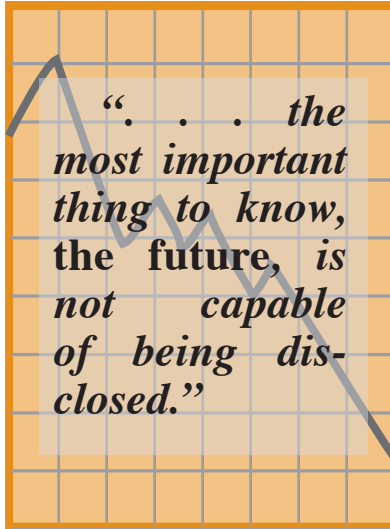
Registration of Public Issues of Stocks and Bonds

When big companies, or any other company, issue large amounts of stock to the public across the country, each company will have to give a huge amount of documentation to the Securities and Exchange Commission (SEC) and to the corporations' departments of the many states administering the "Blue Sky" laws (named for past situations where the investor was said to be buying into nothing more than blue sky). They also have to pay large amounts to the stock brokerage firms that will be raising the capital from the public, the "underwriters." Similarly, large expenses hit the growing company that is tapping the public market for capital for the first time in an Initial Public Offering (IPO). As a practical matter, these costs, the regulations and the disclosures usually keep a company from starting up with a huge amount of money from the public. For example, for an SEC registration, the company must

have several years of audited financial statements of its operations.

Small Companies Tend to Seek Small Amounts from Individual Investors

With public offerings not in their grasp, smaller companies trying to grow their capital from outside (companies grow too by **internal financing**—reinvesting their own profits in the business), from borrowing from banks, and from using several exceptions from SEC registration for smaller offerings. The restrictions in these SEC exceptions guide the companies toward contacting few potential investors, raising relatively small amounts, using a prospectus or offering a circular full of disclosures, and speaking mostly to fairly wealthy potential investors and to people who will be active in the business. In California, the state regulations allow similar exceptions from registration or permitting.



Increasing Disclosures in California Realty Sales

In recent years, laws in California have required more and more disclosures about problems and potential problems with a property. One cannot know them from common sense. For example, in residential sales the buyer has to be told if someone killed himself in the dwelling, but may not inform the buyer that someone died of AIDS there.

Remedies for Investors Who Were Misled

Both the state and federal laws contain remedies for investors, and classes of investors who were harmed from being misled or lied to. Sometimes those remedies are practical for the investor to pursue legally, and sometimes they are not. For example, the investor who makes a bundle on an investment despite having been misled and lied to will seldom end up in litigation. There have been many cases of investors having been misled, sometimes class actions, where a suit in the names of a few investors who were misled by false information, sue for the benefit of everyone else harmed the same way.

DISCLAIMER: THE INFORMATION PROVIDED IN THIS UPDATE IS NOT A SUBSTITUTE FOR LEGAL ADVICE. READERS SHOULD BE ADVISED THAT IF THEY HAVE QUESTIONS ABOUT THIS OR ANY OTHER AREA OF INVESTMENT LAW, THEY SHOULD SEEK THE ADVICE OF COMPETENT COUNSEL SPECIALIZING IN INVESTMENT LAW.

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