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M E M O R A N D U M

To	Private Investment Fund Clients
From	Goodwin Procter LLP
Re	**Pitfalls in Conducting a Private Placement**
Date	September 23, 2013

Preparation and planning (especially with regard to common legal pitfalls) can be an important component in a smooth and successful fundraising. This memorandum provides a brief introduction on three types of legal restrictions that apply to private equity, real estate, venture capital and other types of private funds (collectively, "Private Funds") offering securities in the United States in a private placement: (i) regulation of private placements; (ii) limitations on the payment of success based compensation; and (iii) limitations on the making of gifts and political contributions in connection with raising capital from public or quasi-public institutions. This memorandum is not intended to provide complete guidance on these restrictions, however, and we encourage you to discuss your specific offering with us.

Attached is a checklist of actions we suggest sponsors of Private Funds avoid while marketing a Private Fund.

1. Regulation of Private Placements

A Private Fund planning to offer for sale its limited partnership interests or other similar interests in the Private Fund in the United States without registering such interests under the Securities Act of 1933 (the "**Securities Act**") must comply with the private placement rules of state and federal securities laws while marketing such interests. These rules apply to the Private Fund and to all persons acting on the Private Fund's behalf, such as each sponsor, fund manager, general partner or third party retained to assist in the offering. New federal rules governing private placements require that sponsors of Private Funds confirm that certain "bad actors" are not involved with the sponsor or the offering, and provide a new and, unfortunately, somewhat complicated choice in approaching private placements – whether to avoid general solicitations.

The "Bad Actor" Restriction. The exemption from the registration requirements of the Securities Act provided by Rule 506 of Regulation D ("**Rule 506**"), the exemption generally used by Private Funds, is unavailable if the Private Fund, the sponsor or any of a broad range of persons that are involved with the sponsor or the offering (including beneficial owners of 20% or more of the Private Fund's voting securities and any person that has been or will be directly or indirectly compensated for raising capital), have been the subject of specified findings or orders ("**Bad Act Determinations**") arising from the violation of certain laws or regulations after September 23, 2013. Bad Actor Determinations prior to September 23, 2013 do not cause disqualification but require disclosure. The offering will not be disqualified under Rule 506 if the sponsor did not know and, in the exercise of reasonable care, could not have known of a relevant Bad Actor Determination at the time of the offering. Therefore, prior to

commencing a private placement, a Private Fund sponsor should exercise reasonable care to identify Bad Actor Determinations affecting any person whose involvement, if they are subject to a Bad Actor Determination, would disqualify the offering or require disclosure. We have prepared a memorandum and questionnaire for this purpose.

Whether Or Not To Engage In General Solicitations. Sponsors of Private Funds now have a choice of whether or not to engage in general solicitation of investors while raising capital for a Private Fund. Sponsors that are prepared to conduct their offerings without engaging in any general solicitation, as sponsors have historically done, may rely on Rule 506(b) and should review the guidance contained below in the "Avoiding General Solicitations" section. Private Fund sponsors that prefer not to be restricted from engaging in general solicitations of investors may rely on new Rule 506(c). Before doing so, Private Fund sponsors should carefully consider the implications of that choice. There are several requirements that apply to offerings involving general solicitations that do not apply if the Private Fund sponsor does not engage in any general solicitation. Potentially more significant than the additional requirements is the lack of clarity regarding the implications of a general solicitation on compliance with certain state and non-US regulatory requirements, and the possible application of proposed federal rules that are not yet effective.

Some commentators have suggested that after a Private Fund commences an offering under Rule 506(b) without engaging in general solicitations, it is possible for the Private Fund sponsor to later decide to permit general solicitation and comply with Rule 506(c). While the new federal rules appear to permit this approach, advance planning will be required to comply with the NY requirement described below, and possibly other state and non-US securities law requirements as well.

Additional Requirements for Offerings Involving General Solicitations. Sponsors that engage in general solicitations in an offering must take reasonable steps to verify that each investor is an accredited investor. The SEC has provided guidance in Rule 506(c) and the rule adopting release on what is sufficient in certain circumstances. Merely obtaining a certification from a new investor is not sufficient. Sponsors may hire service providers to provide verification services. Sponsors must reasonably believe that each investor is accredited, and so should understand the steps an outside service provider will take to verify the qualification of investors. Law firms are in the process of formulating their policies regarding giving opinions on offerings conducted pursuant to Rule 506(c) and it may be necessary to rely on one of the safe harbors for verification under the rule if an opinion is required that the offering complies with the rule.

Accredited Investors Only. If a sponsor engages in general solicitation in making an offering under Rule 506(c), then subscriptions can be accepted only from accredited investors (generally, an individual with over $1 million net worth, excluding the net equity in the individual's principal residence, and entities with over $5 million net worth). This limitation may be a concern to sponsors that wish to accept subscriptions from friends and family. Offerings conducted without general solicitation under Rule 506(b) may include up to 35 unaccredited investors if certain additional conditions are satisfied.

No Fallback Federal Exemption. Section 4(a)(2) of the Securities Act provides an exemption from registration for offerings not involving a public offering. Rule 506 is a safe harbor for an offering to qualify under Section 4(a)(2). Sponsors attempting to qualify a Private Fund offering for an exemption under Rule 506(b) that fail to satisfy one or more of the requirements for Rule 506(b) can generally take the position that the offering nevertheless does not involve a public offering and is exempt from registration under Section 4(a)(2). For example, if a Private Fund sponsor fails to discover a Bad Actor Determination that could have been discovered in the exercise of reasonable care, then the sponsor would likely still have a position that the offering was exempt from registration under Section 4(a)(2). However,

if the sponsor engaged in general solicitation in connection with the offering, then the sponsor's ability to rely on the 4(a)(2) exemption would be likely be eliminated.

Reduction of State Securities Law Fallback Exemptions. Federal law preempts state regulation of offerings that are exempt under Rule 506 from registration but not notice filing and anti-fraud enforcement. Many sponsors of Private Funds rely on this preemption to comply with state securities laws. If an offering failed to comply with Rule 506 for any reason and the sponsor instead needed to rely on Section 4(a)(2), federal preemption would be unavailable, and state law limited offering exemptions would generally not be available because they are conditioned on the absence of general solicitation. While most states also have self-operative registration exemptions for offerings to certain institutional investors, these exemptions may not cover the investors solicited in the offering, and state regulators may take the position that these exemptions (which are for *offers and sales* exclusively to institutional investors) are unavailable if there has a been a general solicitation (and thus an offer to persons other than institutional investors).

CFTC Compliance Commodity pool operators are required to register with the CFTC unless an exemption is available. CFTC Regulation 4.13(a)(3), the de minimis exemption, which many Private Funds rely upon, requires that the Private Fund not engage in marketing to the public. While the CFTC has stated publicly that it is exploring whether to modify this regulation to make it available for Private Funds that engage in general solicitation, it has not yet done so. This is a significant concern for Private Funds that plan to purchase "commodity interests" directly or indirectly (e.g., by purchasing interests in underlying entities that own commodity interests) unless the sponsor plans to register as a commodity pool operator or the Private Funds principally invest, directly or indirectly, in real property and take the position that they are not commodity pools. "Commodity interests" include commodity futures, security futures, commodity options and swaps (including interest rate swaps, interest rate caps and currency swaps).

Blue Sky Notice Requirements State securities law compliance for Rule 506 offerings not involving a general solicitation has become relatively straightforward. It is generally limited to making notice filings in the states where subscribers are located after subscriptions are made. In some states, no notice filing is required if the offering satisfies the conditions of a self-executing private placement exemption. Generally, state securities law compliance does not materially affect planning for the offering. State securities regulators are evaluating how to apply, and in some cases revise, state requirements for offerings involving general solicitations. Sponsors considering permitting general solicitation in offering a Private Fund may wish to evaluate applicable state securities requirements (especially in states where notice filings were not typically made) in light of their specific plans. Failure to comply with state securities laws may result in imposition of fines and, in certain instances, demands that the sponsor offer rescission rights to investors. In addition, an enforcement action by a state securities agency would likely require disclosure by sponsors that are registered investment advisers.

New York Blue Sky Requirements The State of New York securities law notice filing requirements merit particular attention. Private Fund sponsors that engage in general solicitations must file a Form 99 with the New York Attorney General's Office ***prior*** to making any offers to investors located in New York. A general solicitation may constitute an offer to New York investors, so unless a Private Fund sponsor has concluded that under no circumstances will the offering include any New York investors, Form 99 should be filed ***prior*** to making any general solicitation that might be viewed as addressed to New York investors. Form 99 also requires a variety of enclosures, including a copy of the offering materials, and disclosure of personal background information about participants in prior offerings that would be considered a "controlling person" (which is broadly defined). Sponsors of Private Funds often engage in informal discussions with prospective investors prior to completing their offering materials. Sponsors should take care that those discussions do not rise to the level of an offer to a New

York person prior to filing Form 99. Also, while Form 99 filings are not currently made publicly available online, the filings are available on request under the New York Freedom of Information Act and therefore may be obtained by trade journals, competitors and others.

Increased Scrutiny. The SEC has announced that it intends to scrutinize offering materials in offerings using general solicitation by registered investment advisers, as has the Massachusetts Securities Division, and we expect that other states may do so as well. We expect that most of this increased scrutiny will be focused on offerings targeted at individual rather than institutional investors, but it suggests an increased risk that compliance issues that might not otherwise receive attention will be raised. While the announced efforts that we are aware of are targeted at sponsors of Private Funds that are registered investment advisers, they suggest the possibility that if sponsors that are not registered engage in general solicitation, it could lead to inquiries as to why they are not required to register, and their approach to broker dealer and other compliance issues generally.

This memorandum does not discuss disclosure requirements in Private Fund offerings. Although Rule 502 of Regulation D does not require specific disclosure for Rule 506 offerings to accredited investors only, sellers are still subject to SEC Rule 10b-5, which makes it unlawful "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Rule 206(4)-8 imposes a similar prohibition on investment advisers to pooled investment vehicles. In connection with the proposed amendments discussed below, the SEC has also proposed to expand the scope of Rule 156, currently applicable to the sales literature of registered investment companies, to apply to sales literature for private funds, as well as for public investment companies. Sales material prepared and distributed by FINRA member broker-dealers is also subject to the content standards of FINRA Rule 2210 (the "Communications Rule").

Proposed Federal Requirements. At the same time the SEC adopted new Rule 506(c) permitting general solicitation in certain offerings, it proposed a number of amendments to the regulations governing offerings that rely on Rule 506(c). It is unclear whether, or when, these changes will be adopted and how they will apply to Rule 506(c) offerings underway at the time they become effective. As a result, sponsors should anticipate that all or some of the following changes may apply to any offerings that they conduct in reliance on Rule 506(c):

1. Currently, sponsors that rely on Rule 506 are required to file a report on the offering (referred to as Form D) within 15 days after the first sale, but failure to comply with this requirement does not affect the availability of the exemption for the registration requirement of the Securities Act of 1933 provided by Rule 506. The proposed amendments to the rules would (i) require that Form D be filed 15 days before engaging in general solicitation under Rule 506(c) and (ii) require the filing of a closing amendment to Form D under certain circumstances within 30 calendar days after terminating any Rule 506 offering. Under the proposed amendments, failure to comply with these new Form D filing requirements by a sponsor or its affiliates during a five year look back period would disqualify a sponsor from relying on Rule 506 for one year after the corrective required Form D filing is made[1].

[1] Proposed Rule 503(b) would permit a sponsor to cure a late filing within 30 days without disqualification, but only once during an offering. The implication of the proposed disqualification provision for the use of new Rule 506(c) to address inadvertent general solicitations is that (assuming there has not been a previous late filing) the sponsor would need to file an amended Form D electing the Rule 506(c) exemption within 15 days after the inadvertent general solicitation or would otherwise be disqualified from using Regulation D for a year after the corrective filing is made. Some commenters on the proposal, including the New York State Bar Association Securities Regulation Committee, have suggested that the SEC should add filing and other procedures making it easier to use Rule 506(c) to cure inadvertent general solicitation.

2. Proposed Rule 509 would require prescribed legends in any written general solicitation materials used in a Rule 506(c) offering. Private Funds that rely on certain commonly utilized Investment Company Act exemptions would also be required to include an additional legend and certain other disclosures.

3. The proposed rules would also require that if such a Private Fund's written general solicitation materials include performance data, then such data must be as of the most recent practicable date considering the type of Private Fund and the media through which the data will be conveyed, and the Private Fund would be required to disclose the period for which performance is presented.

4. Proposed Rule 510T would require issuers to submit any written general solicitation materials used in Rule 506(c) offerings to the SEC no later than the date of first use of these materials. These submissions would not be available to the public and Rule 510T would expire two years after its effective date.

Compliance with Non-US Securities Law This memorandum does not address the implications of general solicitations for compliance with securities laws of jurisdictions outside of the United States. Sponsors considering permitting general solicitations that are planning to seek investors outside of the United States should evaluate the impact that general solicitation may have on compliance with the laws of the jurisdictions where they seek non–US investors.

Avoiding General Solicitation

While there is no precise and all-inclusive definition of what constitutes a "general solicitation," the term generally includes: (i) advertisements (including publicly accessible websites); (ii) articles, notices or interviews published in any newspaper or magazine, or broadcast over television, radio or the Internet; (iii) communications at any conference, seminar or meeting to which attendees have been invited by any communication that itself is a general solicitation; and (iv) any type of publicity generally in each case, if they relate to, or are designed to generate interest in, a planned or ongoing offering or if they have that effect.

This means that ***a Private Fund and persons acting on its behalf may not use any public medium or forum to promote the offering***. Instead, solicitations of, or offers to, prospective investors must be made by the Private Fund or by a fund manager or other person acting on behalf of the Private Fund only in private communications.

Generally permissible activities include: (i) contacting prospective investors with whom the Private Fund or a fund manager or someone acting on behalf of the Private Fund has a pre-existing business relationship that is sufficiently substantive that the person so acting has a reasonable basis to believe the prospective investor is sophisticated and accredited and otherwise qualified to invest in a Private Fund (a "Qualified Investor"), (ii) responding to unsolicited requests for proposals from investors reasonably believed to be Qualified Investors; and (iii) developing substantive relationships with prospective investors through a reasonable amount of customary networking activity provided that there is no solicitation of an investment in the Private Fund until a reasonable time has passed after the creation of the relationship. However, a broad-based, direct mail or telephone campaign that targets prospective investors with whom neither the Private Fund nor a fund manager, nor someone acting on their behalf, has a pre-existing relationship could be challenged as a general solicitation.

Although it is not practical to list every type of communication that could constitute a general solicitation, persons involved in the offering should observe the following general guidelines:

1. Do not speak to the press, grant interviews, or otherwise provide them with materials relating to the offering, including media reports prepared by third parties. If contacted by the press for comments about the offering, all persons should be instructed to reply "**No comment**."

2. Do not discuss the fact that the Private Fund is offering securities at any conference, seminar, or forum to which attendees have been invited by means of any general advertising or solicitation.

3. Do not discuss the track record or other performance data of fund managers of the Private Fund in any public forum in a manner that could be viewed as attempting to "hype" or "condition the market" for the offering.

4. Do not post information relating to the offering on any website that is not "password-protected" and do not allow access to any website with such information other than to prospective investors with whom the Private Fund or fund manager or someone acting on behalf of the Private Fund has a pre-existing substantive relationship sufficient to determine that the prospective investor is a Qualified Investor.

5. Do not offer to sell to or solicit offers to buy from prospective investors other than persons with whom the Private Fund, fund manager or persons acting on their behalf, has a pre-existing substantive relationship sufficient to determine that the person is a Qualified Investor.

Violation of the prohibition on general solicitation may subject the Private Fund to a mandatory "cooling-off" period and civil penalties, and may even give investors a right to rescind their subscriptions at a later date (e.g., after the Private Fund has incurred losses) and be repaid the amount of their investments that have been contributed to the Private Fund. Even if a specific communication were ultimately held not to constitute a general solicitation, contesting an investor's claim that it has a right to rescind its investment could be costly, time consuming, and disruptive.

Although the SEC interprets the meaning of general solicitation broadly to restrict communications in connection with a private placement, it has acknowledged that Private Funds (and companies, generally) must still communicate with the public as part of their ongoing business unrelated to fund raising. As a result, the SEC permits companies to continue their normal course of business communications so long as those communications are not a solicitation of an offer to invest or otherwise designed to generate interest in an investment. While an offering is being planned or underway, it is safest to avoid media attention and publicity beyond what is normal at other times. If the Private Fund or any of its affiliates becomes involved in something newsworthy unrelated to the offering or otherwise wishes to promote its business in a public manner while the offering is underway, care should be exercised to avoid any mention of the offering and to design communications so their purpose and effect is limited to a customary objective of the Private Fund unrelated to the offering, such as developing a deal-flow pipeline. A Private Fund that has not promoted its business (or that of its affiliates) publicly prior to an offering should not do so during an offering, or when one is contemplated, without consulting with counsel.

It is, of course, permissible to speak to the press and the public about the offering ***after the fundraising process has been completed*** (i.e., when the Private Fund had a final closing on all subscriptions and is no longer accepting any subscriptions). However, it may be prudent to avoid such communications even after the fundraising process has been completed because they may complicate or delay re-opening the offering if that later becomes desirable, or may be viewed as a general solicitation by generating interest in a similar subsequent offering that follows quickly after the completion of the first fundraising.

2. Success Based Compensation

The SEC and the states all generally require that any individual or entity who effects securities transactions for the account of others be registered as a broker unless an exemption is available. Private Funds and fund managers should consult with counsel prior to dealing with any proposed finders or other intermediaries and should confirm that the finders or other intermediaries are properly qualified, licensed and registered in each applicable jurisdiction or that they qualify for an exemption from registration. The 2009 revision of the Form D required to be filed with the SEC and state securities regulators in connection with offering under Rule 506 now requires disclosure of the name of, and other information about, any person, including a "finder," that has been or will be paid any direct or indirect compensation in connection with the sales of securities in the offering.

In addition, the duties and responsibilities of employees, officers or individual members or partners of the general partner, the sponsor or the affiliated management company of a Private Fund should not be solely or primarily fundraising nor should such persons be compensated based upon the success, size or amount of the offering of a Private Fund's securities, unless they are appropriately licensed and registered. While there is a safe harbor for persons associated with a Private Fund who solicit investors to invest in that Private Fund, that safe harbor is conditioned, among other things, on the absence of any transaction-related compensation for soliciting investors or helping to close investments in the Private Fund's securities. Salaries and bonuses not tied to the success, size or amount of an offering generally are permissible. Similarly, direct or indirect equity interests in the general partner or management company receiving a management fee from the Private Fund, the grant of which is not tied to the success of the grantee in selling securities, are generally permissible, notwithstanding that the value of and cash flow from such interests are affected by the success of the offering as a whole.

The SEC and the states have recently begun to take enforcement actions against finders who have failed to properly register, even when there is no fraud or other wrongdoing. Certain public or quasi-public pension plans also require that all persons acting as brokers or finders for a Private Fund's offering be properly registered as a condition to investing in that Private Fund.

The consequences for a Private Fund that pays a person who is neither properly registered as a broker under federal or state law nor exempt from registration can be serious. The subscription of any investors introduced to the Private Fund by the unregistered broker can be deemed void, and the Private Fund can be required to offer rescission rights to such investors. This could result in the Private Fund and persons controlling the Private Fund being required to make up any losses suffered by investors and having to refund any fees charged to investors. Triggering rescission rights for the investors introduced to the Private Fund by the unregistered broker may give other investors rescission rights as well.

3. Gifts and Political Contributions and Registration as a Lobbyist

Private Funds and their fund managers considering soliciting investments from state university endowments, public pension plans and other investors that are public or quasi-public agencies or entities should be aware of rules and policies adopted by or otherwise applicable to certain of those investors that restrict or require disclosure of gifts or campaign contributions to employees, trustees, or other government officials associated with such public or quasi-public agencies or entities or require persons involved in soliciting an invest to register as a lobbyist. In some cases the applicable rules or policies apply to contributions made to any elected official of the state with which the investor is affiliated. Prior to any person affiliated with a Private Fund making a gift or contribution to anyone associated with a public or quasi-public agency or entity (which can include a wide range of government officials), fund managers should investigate whether such gifts or contributions are subject to reporting requirements or

will prohibit such agency or entity from making an investment in the Private Fund, and whether registration as a lobbyist is required.

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This memorandum is intended only as a general discussion of the information presented and should not be regarded as legal advice. For more information, please contact your Goodwin Procter LLP attorney.

PRIVATE PLACEMENT PITFALLS

1. **Involving "Bad Actors".** Confirm that no one involved with the sponsor or the offering is subject to a finding or order that will disqualify the offering or require disclosure under the "bad actor" rule.

2. **Retaining an Intermediary to Assist in the Offering Unless the Intermediary is Properly Registered.** Do not retain a broker or finder to assist in an offering without verifying that the intermediary is appropriately licensed and registered.

3. **Employing and Compensating Unlicensed Brokers.** Unless a person is appropriately licensed and registered, his or her sole or primary function on behalf of a general partner, or affiliated management company or sponsor of a Private Fund, whether as principal, employee or independent contractor, should not be fundraising. Nor should the compensation of any such person that is not appropriately licensed and registered be based upon the success, size or amount of an offering or the employee's success in arranging investor subscriptions

4. **Making Gifts or Contributions to Persons Affiliated with Public or Quasi-Public Agencies or Entities.** Prior to making a gift or campaign contribution to anyone associated with a state university endowment, public pension plan or other public or quasi-public agency or entity, investigate whether such gifts or contributions are subject to reporting requirements or will prohibit the agency or entity from making an investment in the offering.

For Sponsors That Elect to Reserve the Ability to Make General Solicitations in Connection with Their Offerings

5. **If Soliciting New York Investors, Make the New York Pre-Solicitation Filing.** Before engaging in a general solicitation that may be viewed at targeted at New York investors, or discussing the offering with prospective New Your investors, even privately, comply with the New York pre-solicitation filing requirement.

6. **Evaluate State Blue Sky and Non-US Securities Law Compliance Requirements in Advance**. Before discussing the offering with prospective investors, even privately, evaluate other blue sky compliance requirements in the states and non-US jurisdictions where investors may reside.

For Sponsors That Elect to Avoid General Solicitations in Connection with Their Offerings

7. **Mentioning the Offering to Media**. Do not mention the offering to the press, grant interviews, or furnish materials relating to the offering to any reporter or other source of media coverage. If contacted by the press for comments about the offering, all persons should be instructed to reply "**No comment.**"

8. **Failing to Carefully Restrict Non-Offering Media Attention**. Avoid any interviews about the Private Fund or other media attention unless clearly focused on activities unrelated to the offering. We strongly recommend discussing with counsel in advance any media attention that relates to or could be viewed as generating interest in the Private Fund while the offering is planned or ongoing.

9. **Failing to Keep the Offering Confidential**. Do not discuss the fact that the Private Fund is being formed or offering securities at any conference, seminar, or public forum to which attendees have been invited by means of general advertising or general solicitation.

10. **Hyping the Private Fund in Public**. Do not discuss the track record or other performance data of persons affiliated with the Private Fund in any public forum in a manner that could be viewed as attempting to "hype" or "condition the market" for the offering.

11. **Disclosing the Offering on any Website Unless Password Protected**. Do not post (and do not allow anyone acting on behalf of the Private Fund or its sponsors to post) information relating to the offering on any website that is not "password-protected" and do not allow access to any website with such information other than to persons with whom the Private Fund or someone acting on its behalf has a substantive pre-existing relationship sufficient to provide a basis for determining that the person is sophisticated and accredited and otherwise qualified to invest in a Private Fund.

12. **Soliciting Investors Without First Establishing a Substantive Relationship**. Do not solicit interest from individuals or other prospective investors without having or establishing a substantive relationship sufficient to provide a basis for determining that the prospective investor is sophisticated and accredited and otherwise qualified to invest in a Private Fund.