DechertOnPoint

August 2007 / Issue 24

A legal update from Dechert's Financial Services Group

SEC Releases Proposed Amendments to Simplify and Require Electronic Filing of Form D

On June 29, 2007, the Securities and Exchange Commission (the "SEC") issued a release (the "Proposing Release"), which it approved on May 23, 2007, proposing amendments that would mandate the electronic filing of information required by Form D, simplify the process of filing Form D, and revise and update the information required to be furnished in Form D.[1]

Significantly, any data filed as part of Form D would be available on the SEC's web site and freely available to anyone who chooses to access it. These proposals are meant to bring the filing of Form D to the 21st Century by establishing an electronic system for Form D filings and to address deficiencies in the Form D data collection requirements and industry comments requesting that Form D be clarified and simplified.

Background of Form D

Section 5 of the Securities Act of 1933, as amended (the "Securities Act") generally requires registration of any security offered or sold through the use of any means of United States interstate or international commerce. Section 4(2) of the Securities Act and Regulation D provide a private placement exemption from registration under the Securities Act for any offer or sale of a security by an issuer that does not involve a public offering. When an issuer makes an offering in the United States pursuant to Regulation D, Rule 503 requires such issuer to file with the SEC Form D within 15 days after the first sale of securities.[2] The broad reach of Regulation D even applies to the sponsor of a non-U.S. domiciled fund making a private offering in the United States.

The objectives for proposing to amend Form D are to improve its utility and to modernize the filing process. The SEC believes that much of the information required by Form D is useful and justified in the interests of investor protection and capital formation. However, the SEC also acknowledges that some useful information that could be elicited by Form D currently is not required and that some of the information currently required to be furnished is no longer useful. The SEC further acknowledged in the Proposing Release that the absence of an electronic system for filing Form D information prevents issuers from filing through efficient modern methods and limits the usefulness of the information collected on Form D.

Proposals for Form D

Electronic Filing

Paper filing would be eliminated; instead, issuers would file electronically through a new online filing system that would be accessible

[1] Release No. 33-8814 (June 29, 2007). The comment period for the proposed amendments will close on September 7, 2007.

[2] An issuer may be required to file additional blue sky filings in the state where the purchase of securities occurred depending on such state's blue sky laws.

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from the Internet.[3] This proposed filing process would be similar to that available for filing Form ADV electronically with the Investment Adviser Registration Depository. The SEC currently requires issuers to deliver five paper copies of the Form D by mail or physical delivery to SEC headquarters. The proposal would require issuers to provide the requested information in data fields by responding to a series of questions.

The proposed software would require that filers address each required data field in the form as a pre-condition for submitting Form D electronically, thus precluding incomplete filings. The filing would continue to be required to be made within 15 days of the first sale of securities to U.S. investors in reliance on one or more of the exemptions provided in Regulation D.

Currently, copies of Form D paper filings are available only from the SEC in person or by mail request and at a nominal fee. To promote greater transparency, the proposed online filing system would be interactive and would enable online users to search for information that would be downloadable and freely available to anyone choosing to access it.

In addition, in the Proposing Release the SEC expressed the hope that state securities regulators would permit "one stop" filing whereby a Form D filed electronically with the SEC would satisfy state law filing requirements where the offering is covered by a federal filing.[4] This development, if it were to occur, would be invaluable to issuers making sales in numerous U.S. states, since filing Form Ds in numerous states is a redundant, time-consuming, and costly process.

Substantive Changes to Form D

The following are some of the substantive amendments proposed to Form D:

- The current requirement that issuers identify owners of 10 percent or more of a class of their equity securities as "related persons" would be modified,[5] so that only the identification of executive officers, directors, and promoters in Item 3 would be required.
- Rule 503 would be revised to require amendments to Form D in the following three circumstances:
  - to correct a mistake of fact in a previously filed notice;
  - to reflect a change in the information provided in a previously filed notice, except in certain specified instances (e.g., a change in an issuer's revenues, a change in the number of accredited investors who have invested, and a change in information on related persons with respect to offerings that last more than a year); and
  - in offerings that last more than a year, to file amendments on an annual basis between January 1 and February 14, to reflect information about the offering on or before its termination since the later of the filing of the Form D or the filing of the most recent amendment.[6]
- An issuer that files an amendment would be required to provide current information in response to all requirements of Form D regardless of the reason that the amendment was filed.

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3 To file Form D electronically, an issuer would be required to obtain EDGAR filing codes, i.e., a Central Index Key ("CIK") code.

4 However, the contemplated electronic filing system would not collect any fee a state might charge on behalf of the state.

5 The SEC is proposing to eliminate the inclusion of 10 percent equity owners because issuers that are not reporting companies have raised privacy concerns with respect to the requirement to identify 10 percent equity owners who are not executive officers, director, or promoters since private companies do not already have to disclose this information.

6 The proposed obligation to require the issuer of continuous offerings to file annual amendments to Form D would more likely affect hedge funds compared to other private funds such as private equity funds and venture capital funds because such funds tend to close within one year from the time of launch.

- The federal and state signature requirements in Sections D and E of the current Form D would be merged into one signature requirement. The SEC also proposes incorporating into the signature block the consent to service currently contained in Form U-2, which is required to be filed separately but simultaneously with a Form D by many states. This combined signature requirement, in general, would provide that each issuer signing the revised Form D has read it, knows the contents to be true, has duly caused it to be signed on its behalf by the undersigned duly authorized person, and is:
  - notifying the SEC and the U.S. states in which the Form D is filed of the offering and undertaking to furnish to them, on written request, the information provided by each issuer to offerees;
  - consenting to service of process on individuals holding specified positions; and
  - certifying that it is not disqualified from relying on Regulation D for one of the reasons stated in proposed Rule 502(e).
- Issuers would still be required to provide current Form D information on sales compensation, but with certain additional requirements. Significantly, the SEC is proposing to add an additional requirement that the issuer provide the Central Registration Depository number of each recipient of sales compensation named in Item 12. This additional disclosure requirement could force some issuers to shift away from utilizing unlicensed brokers and finders and to rely exclusively on registered broker-dealers to serve as placement agents.
- The current requirements to provide the amount of total sales and the total offering amount would be retained, but in a restructured, simplified format. Instructions would be added to clarify interpretive issues that have arisen in completing the form, such as how to respond if the amount of an offering is undetermined when the Form D filing is made.
- Post office box numbers and "care of" addresses would no longer be permitted as acceptable place of business information.[7] The rationale for this proposal is that such information does not allow securities enforcement authorities to determine the location of the issuer's operations and personnel responsible for the offering.
- Issuers would continue to be required to identify the exemption or exemptions being claimed for the offering, (i.e., Rule 504, 505, 506, proposed Rule 507, and Section 4(6), as applicable). In addition, relevant to private funds, an issuer would be required to identify the exclusion from the definition of "investment company" under the Investment Company Act of 1940 upon which the issuer is replying (e.g., Section 3(c)(1) or 3(c)(7)).
- Issuers would be required to identify their industry group from a drop-down menu by selecting an industry group classification from a pre-established list. The proposed drop-down menu for industry group includes the category of "Pooled Investment Fund" and four sub-categories to select: Hedge Fund, Private Equity Fund, Venture Capital Fund, and Other Investment Fund.
- The issuer would be required to indicate whether it intends that the offering will last over a year. Issuers of continuously offered private funds (typically hedge funds), would have to indicate "yes."
- Issuers would be permitted to designate the states to which the Form D is directed.
- The identification of multiple issuers in multiple issuer offerings would be required.

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[7] This amendment could affect hedge funds, in particular offshore funds, since they typically have a registered office that contains either a post office box number or an address "care of" its secretary or administrator.

This proposal would eliminate the burden on issuers of having to file duplicate Form Ds for each issue.

- Issuers would be required to furnish their revenue range information from a drop-down menu.[8] As proposed, the revenue range would be for the most recently completed fiscal year. Where an issuer has been in existence for less than a year, e.g., a start-up fund, it would identify its revenues to date.

- The requirement that issuers provide the name of the offering (i.e., the fund name) would be deleted.

- Items currently requiring information on use of proceeds and expenses of the offering would be eliminated.

- The current requirement to indicate whether a limited partnership issuer already has been formed or is in formation would be eliminated. The SEC believes that sufficient information will be obtained from the requirement to provide an issuer's year of incorporation or organization.

- The Form would continue to require the issuer to specify the minimum investment amount. According to the SEC staff, the SEC is maintaining this requirement because offerings that have low minimum investment amounts have presented particular enforcement challenges in the past.

Safe Harbor from Prohibition on "General Solicitation" and "General Advertising"

By making the information furnished in Form D publicly available via the Internet, there is a concern that issuers relying on Regulation D would in effect be violating the prohibition on the use of "general solicitation" and "general advertising" under Rule 502(c) of Regulation D. To address these concerns, the SEC is proposing to revise Rule 502(c) to include a safe harbor from the prohibition on "general solicitation" and "general advertising" for information provided in Form D filed electronically with the SEC if the information was provided in good faith and the issuer made reasonable efforts to comply with the requirements of Form D.

An issuer that complies with the terms of the safe harbor would be assured that the electronic availability of its Form D filing would not, in and of itself, cause the issuer to have violated this prohibition. However, such a safe harbor would not be available if an issuer was attempting to shield activity intended to create interest in an offering.

Conclusion

The proposed amendments would make welcome changes to Form D by establishing an electronic system for Form D filings, addressing perceived deficiencies in the Form D data collection requirements, and making it relatively easy to file, access, and analyze Form D information.

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[8] The SEC intends to use this information to determine the types and sizes of issuers that rely on Regulation D and Section 4(6) exemptions.

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