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SEC Lifting the Ban on General Solicitation & What it Means for You

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Welcome

AGENDA

- Using General Solicitation in Private Offerings, *Jonathan Axelrad*
- Disqualification of Offerings Involving "Bad Actors," *Brad Weber*
- Proposed Changes to Reg D, Form D and Rule 156, *Tom Beaudoin*
- CFTC Interaction, *Brynn Peltz*
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- Panel discussion, *all*

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Using General Solicitation in Private Offerings:

Introduction to New Rule 506(c) for Emerging Companies and Private Investment Funds

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August 1, 2013

Introduction

- For many decades, emerging companies and private investment funds generally had only two choices when seeking to issue securities:
  - A fully registered public offering, or
  - A private offering "not involving any public offering"
- The Jumpstart Our Business Startups Act (JOBS Act) created a third path
  - Directs the U.S. Securities and Exchange Commission (SEC) to adopt new rules
    - A general solicitation of the public to be permitted, without public offering-style registration, so long as securities issued only to accredited investors
  - New Rule 506(c) adopted by the SEC on July 10, 2013
    - Will become effective September 23, 2013

Introduction

- Rule 506(c) likely will have a significant impact on fundraising behavior by many companies and funds
  - Will promote use of the Internet in fundraising, and more generally expand the pool of potential investors
  - Will ease restrictions on speaking with the press
  - May shift the balance of power among fund managers and entrepreneurs/portfolio company management
  - Etc.
- However, Rule 506(c) has its requirements and limitations
  - Required verification that investors are accredited
  - Doesn't impact anti-general solicitation rules in jurisdictions outside the U.S.
  - Doesn't permit even a limited number of non-accredited investors (such as knowledgeable employees)

Introduction

- Many securities regulators and other persons worry that Rule 506(c) will facilitate fraud against investors
  - SEC simultaneously adopted new rules that prohibit participation by "bad actors" (see separate presentation)
  - SEC has proposed new oversight and compliance rules (see separate presentation)
  - Federal and State regulators may seek broader application of existing anti-fraud rules
  - Future changes to the definition of "accredited investor" are possible
  - SEC and State examiners may take a more skeptical approach when reviewing offerings that involve general solicitation
  - The plaintiffs' bar is already looking to drum-up business

Background

- Under Section 5 of the U.S. Securities Act of 1933 (the Securities Act), an issuance of securities generally must comply with highly burdensome registration requirements unless an exemption is available
- Section 4(a)(2) of the Securities Act generally exempts transactions by an issuer "not involving any public offering"
- Rule 506(b) is a non-exclusive safe harbor under Section 4(a)(2) which generally permits an issuer to sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors
  - For a non-accredited investor, the issuer must reasonably believe that the investor possesses, alone or with the assistance of a representative, "such knowledge and experience in financial and business matters that he [or she] is capable of evaluating the merits and risks of the prospective investment"
    - The issuer must also provide very substantial information about the offering, potentially comparable to information provided in a registered offering
  - For other investors, the issuer must "reasonably believe" that such investors are accredited
    - No specific verification required
    - Typically, investors are asked to complete a brief questionnaire

Background

- The offering of securities must not include any form of “general solicitation or general advertising” (commonly called “general solicitation”)
- There is no single, all-encompassing definition of general solicitation. However, it generally is deemed to include:
  - Advertisements in newspapers and magazines
  - Communications broadcast over television or radio
  - Seminars to which attendees have been invited via general solicitation
  - Other uses of publicly available media, such as unrestricted websites
  - Variations on the foregoing (giving press interviews that effectively advertise the offering, email marketing campaigns, etc.)
- Given the lack of a bright line definition, attorneys who advise issuers tend to caution against public communications that advertise the offering even on an indirect basis

Background

- The qualifications for accredited investor status are set forth in Rule 501(a)(1)-(8)
  - In general, an individual may be an accredited investor if such individual:
    - Has annual income exceeding $200,000 per year (or $300,000 per year collectively with a spouse), or
    - Has net worth (individually or collectively with a spouse) in excess of $1 million (disregarding the net value of a primary residence), or
    - Is a director, executive officer or general partner of the issuer (or of the general partner of the issuer)
  - In general, an entity may be an accredited investor if:
    - The entity has total assets in excess of $5 million, or
    - All of the entity's equity owners are accredited investors, or
    - The entity otherwise qualifies under Rule 501(a)

Background

- Many commentators have urged that the qualifications for accredited investor status be made more rigorous
  - In particular, the annual income standards have not changed since 1982
  - In 2011, based on 2007 data, the SEC staff estimated that approximately 8.3 million U.S. households are accredited (using the most current qualification standards for income and net worth)

New Rule 506(c)

- Under Rule 506(c), the prohibition against general solicitation is eliminated
  - Issuers generally may engage in ALL forms of communication when offering their securities
  - Yes, you can put a coupon in the Sunday circular
- However, there are some new requirements
  - Even though securities may be offered to the entire public, ***all*** investors to whom securities are actually sold must be accredited, or the issuer must reasonably believe they are accredited
    - No opportunity for “up to 35” non-accredited investors (but see below)

New Rule 506(c)

- The issuer must take "reasonable steps to verify" that all investors are accredited
  - What constitutes "reasonable steps" will be an objective determination, based on all facts and circumstances such as:
    - The nature of the investor (e.g., individual vs. institution)
    - The amount and type of information known by the issuer about the investor
    - The nature of the offering (e.g., a very high minimum investment size)
  - Mere self-verification by an investor (e.g., checking a box on a subscription or stock purchase agreement) generally will not be deemed sufficient
    - Self-verification may be available for pre-existing investors in same issuer
  - Rule 506(c) provides a non-exclusive and non-mandatory list of verification methods that are deemed reasonable
  - Third-party providers have already started offering verification services
  - See separate presentation for additional detail

New Rule 506(c)

- If reasonable steps to verify accredited status are taken, and the issuer reasonably believes that the investor is accredited, Rule 506(c) qualification will not be lost merely because the investor is not, in fact, accredited
  - Thus, an issuer who has been deceived by an investor should not thereby lose the benefits of Rule 506(c) -- if the issuer followed proper procedures

506(b) vs. 506(c)

- Rule 506(c) is an alternative to Rule 506(b), not a replacement
  - Thus, each issuer can choose which approach to take
  - The SEC has revised Form D* to require that an issuer check a box to indicate whether the issuer is relying on Rule 506(b) or 506(c)
    - It appears that simultaneous reliance on both is not permitted (for the same offering)
    - It may be possible to switch from one to the other by filing an amended Form D
    - However, as a practical matter, it may be impossible to switch to Rule 506(b) after having engaged in general solicitation in reliance on Rule 506(c)
  - Under a transition rule, an issuer that relied upon Rule 506(b) prior to September 23, 2013 may switch to Rule 506(c) on a going-forward basis

* In general, an issuer must file Form D within 15 days of the first sale of securities pursuant to an offering under Rule 506(b) or (c)

Reasons to Prefer 506(b)

- Many issuers will be very excited about the prospect of conducting a general solicitation under Rule 506(c)
- However, 506(b) retains some advantages, including:
  - Issue securities to non-accredited investors
    - Under 506(b), securities may be issued to not more than 35 non-accredited investors
    - Note: For a private fund offering under Rule 506(c), there may be some limited ability to share fund economics with non-accredited persons (such as junior team members) via granting interests in the GP entity
      - Must structure the transaction so that it is not integrated with the primary offering of interests in the fund
    - Note: It also is possible to issue securities to non-accredited foreign investors via a simultaneous offshore Regulation S offering
      - No need to comply with requirements of Rule 506(b) or (c)

Reasons to Prefer 506(b)

- Avoid accredited investor verification requirements
  - Some potential investors may object to perceived privacy issues associated with verification
- Minimize conflict with non-U.S. laws
  - The private offering rules of many other countries include a ban on general solicitation similar to Rule 506(b)
  - It's unclear exactly how a general solicitation in the U.S. (e.g., through an unrestricted website) will be viewed under the laws of other countries
  - Presumably, this will be relevant only for those countries in which the issuer may actually seek investors

Reasons to Prefer 506(b)

- Stay out of “cross hairs”
  - The SEC and many State regulators have expressed concern that general solicitations may increase the volume and severity of fraud against investors
  - Plaintiffs’ bar is already trolling for new clients (see handout)
  - It seems reasonable to assume that general solicitations will attract some degree of increased scrutiny and attention (see below)
  - Rule 506(c) preempts many State securities (i.e., “blue sky”) laws, including their prohibitions on general solicitation
    - Nevertheless, within the bounds of such preemption, State regulators may seek to impose additional burdens in an effort to limit opportunities for fraud at the State level
    - Watch out for notice filing and fee requirements, especially where exemptions are conditioned upon avoidance of general solicitation

Reasons to Prefer 506(b)

- Avoid potential regulation by the Commodities Futures Trading Commission (CFTC)
  - Generally a concern only for certain private fund managers who utilize derivative financial instruments (e.g., for hedging)
  - Awaiting guidance from the CFTC on whether general solicitation will preclude otherwise available exemptions
  - See separate presentation
- Avoid potential "gun jumping" in connection with a contemplated IPO
  - Depending on the facts and circumstances, a general solicitation under 506(c) might be viewed as "gun jumping" if conducted in close proximity to an IPO

Reasons to Prefer 506(b)

- Avoid other potential legal conflicts
  - The prohibition against general solicitation in private offerings has been in place so long that many regulatory and other legal regimes are based on the assumption that it applies
  - It may be many months before the legal community identifies all the major actual/potential conflicts that result from use of Rule 506(c)
    - Note: In general, it seems clear that use of Rule 506(c) should not cause a private fund to be deemed an "investment company" under the U.S. Investment Company Act of 1940 (i.e., "3(c)(1)" and "3(c)(7)" exemptions should remain intact)

Reasons to Prefer 506(c)

- Of course, 506(c) offers many potential advantages
  - Access to a greatly enhanced pool of potential investors
    - Even though securities may be sold only to accredited investors, a general solicitation may bring the offering to the attention of many more accredited investors than could otherwise be contacted
    - It is expected that third-party "web portal" operators will make a business of bringing issuers and accredited investors together
      - This process has already started with such companies as FundersClub and AngelList
  - Greater leverage for issuer vis-à-vis any specific investor
    - In general, an issuer that has multiple choices about how to raise capital will have greater leverage in negotiations with any particular capital source
    - For private fund managers, this may be a double-edged sword
      - Greater leverage vis-à-vis their Limited Partners, but reduced leverage vis-à-vis portfolio companies

Reasons to Prefer 506(c)

- Greater control over "public persona"
  - Even issuers that do not want or need to access a larger pool of investors may benefit from increased flexibility regarding public communications
  - For example, enhanced ability to:
    - Issue press releases without concern about timing of financing closings
    - Speak more freely to the press and provide accurate information to reporters who might otherwise publish inaccurate information
    - Add greater detail to the issuer's website to promote greater public understanding of the issuer's business/operations/mission
    - Be more explicit in general marketing materials about fundraising/financial status
      - For example: "You can count on us to be around for the long term. We've already closed on 80% of our $100 million fundraising goal."

Reasons to Prefer 506(c)

- Protection against “foot faults”
  - Often, issuers will experience a crisis during fundraising due to inadvertent general solicitation
    - “Slip of the lip”
    - Behavior of junior personnel who don’t understand the rules
    - Getting caught by reporters who misleadingly assure issuer personnel that “it’s OK for you to talk to me so long as it’s off the record”
  - In recent years, the SEC and other regulators have not dedicated many resources to minor breaches of the prohibition against general solicitation
    - Given the new availability of Rule 506(c), such breaches may be more likely to attract enforcement action
    - “We gave you a clear path, and you ignored it . . . .”

Anti-Fraud Considerations

- The SEC has proposed rules that would impose substantial new anti-fraud burdens and obligations on issuers in private offerings (see separate presentation)
- The public comment period for these proposed rules ends September 23, 2013
  - It remains to be seen what will be included in any final rules and when such final rules will be adopted
- The adoption of Rule 506(c) did NOT change existing anti-fraud law applicable to private offerings

Anti-Fraud Considerations

- Existing law includes:
  - Rule 10b-5 under the Securities Exchange Act of 1934

"It shall be unlawful for any person . . .

(a) To employ any device, scheme, or artifice to defraud,

(b) 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, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Anti-Fraud Considerations

- Section 206 of the Investment Advisers Act of 1940

"It shall be unlawful for any investment adviser . . .

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction . . .; or

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative."

Anti-Fraud Considerations

- Rule 206(4)-8 under the Investment Advisers Act of 1940

"It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act . . . for any investment adviser to a pooled investment vehicle to:

(1) Make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or

(2) Otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle."

Anti-Fraud Considerations

- Historically, except for specialized issuers (such as registered investment advisers) existing law has not been interpreted to impose many specific, detailed, formulaic requirements upon issuers
  - Courts and administrative guidance have focused upon the substance of fraud or deception
  - This is a key reason why private offering materials have been less burdensome to prepare than IPO materials
  - However, the rules themselves are ambiguous and open to a great deal of interpretation
    - Exactly what is "deceptive"?

Anti-Fraud Considerations

- Even though the law has not changed, the environment in which it will be applied and interpreted has changed significantly
  - As noted above, the SEC and state regulators are worried that general solicitations will increase the volume and severity of fraud upon investors
  - That worry alone may trigger enhanced scrutiny and/or enforcement action
  - An actual increase in fraud, especially if publicized in the press or otherwise, likely would trigger a substantial reaction by SEC/regulators
  - Any new awareness of certain types of deceptive or other problematic behavior could give rise to interpretations of the rules that are applied ***retroactively***

Anti-Fraud Considerations

- Even a brief investigation by the SEC/State regulators could be highly problematic
  - Often must be disclosed to prospective investors
  - Could be costly, time consuming, and distracting to respond
  - Once regulators are suspicious, even perfectly innocent and reasonable behavior can trigger deep scrutiny

Anti-Fraud Considerations

- Thus, it will be advisable to exercise greater caution going forward, especially in the context of an offering that includes general solicitation
  - Use particular care in any descriptions of prior performance or financial data
    - Identify difference between gross and net returns
    - Identify method used to value non-marketable assets
  - Include cautions and disclaimers, even in informal marketing communications (e-mails, pitch-decks, etc.)
    - Past performance does not predict future performance
    - Risk of loss
    - Reference to complete set of disclosure materials in PPM, etc.
  - More generally, when preparing marketing materials, ask yourself "could this reasonably be seen as misleading?"
  - Watch-out for social media
    - Tweets and Facebook posts are not exempt from the anti-fraud rules

Rule 506(c) is NOT "Crowdfunding"

- The JOBS Act also created a separate exemption from registration for "crowdfunding"
- In general, the crowdfunding exemption should enable online capital raising from an unlimited number of investors, including non-accredited investors, through social media and other channels
  - The exemption will not be available until rules are adopted by the SEC, currently expected to be late 2013/early 2014
- Key requirements:
  - Total amount raised by an issuer cannot exceed $1M in a 12-month period
  - Investment amount capped by reference to an investor's income or net worth (and the cap will aggregate all crowdfunded investments by that investor in a 12-month period)
  - Advertisements must be limited and, in particular, must instruct potential investors to contact a funding intermediary rather than the issuer (see below)

Rule 506(c) is NOT "Crowdfunding"

- Crowdfunding must be conducted through a registered broker-dealer or registered "funding portal," which acts as an intermediary/gatekeeper
  - A funding portal must (a) be a member of a registered national securities association (e.g., FINRA), (b) be subject to SEC examination, enforcement and rulemaking and (c) meet additional SEC rule requirements (to come)
- The issuer must file with the funding intermediary and the SEC a disclosure document at least 21 days prior to the first sale of securities
- Audited financial statements required for raises >$500K
- Post-closing, annual reports (and possibly more frequent reports, depending on SEC rulemaking) must be filed with the SEC

- Current status: Awaiting further details from the SEC

Conclusions

- Rule 506(c) will significantly change the fundraising landscape
  - Many issuers will elect to conduct general solicitations
  - Web-based and other intermediaries will join the fray, seeking to match issuers and investors
  - Even issuers that don't seek to conduct general solicitations may gain greater control over their public communications
  - There will be changes in negotiating leverage between issuers and investors
- Yet, there will be challenges
  - Some investors may resist accredited status verification procedures
  - It may take many months before conflicts with other laws are fully understood and addressed
    - Some may never be addressed
    - In some cases, a general solicitation under 506(c) may force delay of other transactions (e.g., an IPO)
  - Rule 506(c) simply will not be available to some issuers
    - E.g., those who must sell to a limited number of non-accredited investors
  - Regulators and plaintiffs' counsel will be watching closely
    - Careful preparation of marketing and disclosure materials is strongly advised

Thank You

These materials are provided for general information only and do not constitute legal advice. For assistance with regard to any specific situation, please contact your Goodwin Procter LLP attorney.

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Disqualification of Offerings Involving "Bad Actors" From Using Rule 506

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August 1, 2013

Basics of New Subsection (d) of Rule 506

An issuer will not be able to rely on the Rule 506 safe harbor for an offering if the issuer, any predecessor of the issuer, any affiliated issuer or certain other covered persons related to the issuer or involved in the offering are considered bad actors as described in the rule,

UNLESS

- A limitation or exception applies
- A waiver of disqualification is obtained from the SEC
- The court or regulatory authority that ruled on the bad act advises in writing that disqualification should not apply

Parties Whose Actions Are Relevant for Rule 506(d)

- The issuer
- Any predecessors of the issuer
- Affiliated Issuers
- Covered Persons
  - All directors and executive officers of the issuer
  - Any other officers of the issuer who are participating in the offering
  - General partners or managing members of the issuer
  - Beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power
  - Promoters connected with the issuer in any capacity at the time of such sale

(continued)

Parties Whose Actions Are Relevant for Rule 506(d)

- Covered Persons (continued)
  - Any investment manager of an issuer that is a pooled investment fund
  - Any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities
  - Any general partner or managing member of any such investment manager or solicitor
  - Any director, executive officer, or other officer participating in the offering, of any such investment manager or solicitor, or general partner or managing member of such investment manager or solicitor

Disqualifying Events

- Criminal convictions in connection with the purchase or sale of a security, making of a false filing with the SEC or arising out of the conduct of certain types of financial intermediaries (the criminal conviction must have occurred within 10 years of the proposed sale of securities or five years in the case of the issuer and its predecessors and affiliated issuers)
- Court injunctions and restraining orders in connection with the purchase or sale of a security, making of a false filing with the SEC, or arising out of the conduct of certain types of financial intermediaries (the injunction or restraining order must have occurred within five years of the proposed sale of securities)

(continued)

Disqualifying Events (continued)

- Final orders from the Commodity Futures Trading Commission, federal banking agencies, the National Credit Union Administration, or state regulators of securities, insurance, banking, savings associations or credit unions that (x) bar the issuer from associating with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities or (y) are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years of the proposed sale of securities
- Certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisers and their associated persons

(continued)

Disqualifying Events (continued)

- SEC cease-and-desist orders related to violations of certain anti-fraud provisions and registration requirements of the federal securities laws (the order must have been entered within five years of the proposed sale of securities), certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisers and their associated persons
- Suspension or expulsion from membership in a self-regulatory organization ("SRO") or from association with an SRO member
- SEC stop orders and orders suspending the Regulation A exemption issued within five years of the proposed sale of securities
- U.S. Postal Service false representation orders issued within five years before the proposed sale of securities.

Limitations and Exceptions

- Issuer will not be disqualified if the "disqualifying event" occurred before the effective date of the new final rule (September 23, 2013)
- However, new subsection (e) of Rule 506 requires that issuers must disclose "disqualifying events" that occurred before September 23, 2013 to investors
- Rule 506(e) requires:
  - Disclosure must be provided a "reasonable time prior to sale"
  - Disclosure of the disqualifying event must be given "reasonable prominence…to ensure that information about the event is appropriately presented in the total mix of information available to investors"
- Failure to disclose results in a loss of the 506 exemption for the offering in question

Limitations and Exceptions (continued)

- If the issuer establishes that it did not know and, in the exercise of "reasonable care", could not have known that a disqualification existed at the time of the offering, the event will not be disqualifying under Rule 506(d) and failure to disclose will not result in loss of exemption under Rule 506(e)
- An issuer will not be able to establish that it has exercised "reasonable care" unless it has made, in light of the circumstances, "factual inquiry" into whether any disqualifications exist
- A factual inquiry by means of questionnaires and certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient in some circumstances

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Thank you

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Appendix A – Affiliated Issuer Limitation

- Events relating to any affiliated issuer that occurred before the affiliation arose will not be considered disqualifying if the affiliated entity is not:
  - In control of the issuer, or
  - Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events

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SEC Lifting the Ban on General Solicitation - Proposed Changes to Regulation D, Form D and Rule 156 under the Securities Act

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August 1, 2013

Proposed Changes to Regulation D, Form D and Rule 156

Agenda

- Form D Filing Requirements
- Proposed Changes to Form D
- Disqualification Amendments (Rule 507)
- Proposed Disclosure Requirements (new Rule 509)
- Submission of General Solicitation Materials (new Rule 510T)
- Application of Rule 156 to Private Funds

Proposed Changes to Regulation D, Form D and Rule 156

Form D

- Data collection device for investors and regulators
- Used by State regulators to look for “red flags”
- Filed on EDGAR
- Filing of Form D is not a condition to qualify for a valid exemption under Rules 504, 505 and 506

Proposed Changes to Regulation D, Form D and Rule 156

Form D Filing Requirements

- Current Filing Rule: Issuer selling securities in reliance on Rules 504, 505 or 506 of Reg. D must file Form D not later than 15 days after first sale of securities in the offering
- Proposed Filing Rule for Rule 506(c) offerings: Issuer that intends to engage in general solicitation for a Rule 506(c) offering must file an "Advance Form D" at least 15 days prior to commencing general solicitation
  - Certain information not required in Advance Form D (e.g., size of issuer; offering and sales amount); remaining information filed on Form D not later than 15 days after first sale of securities

Proposed Changes to Regulation D, Form D and Rule 156

Form D Filing Requirements

Proposed Filing Rule for Rule 506 offerings: Issuers offering securities in reliance on Rule 506 must file a "closing amendment" within 30 days after termination of the offering; perhaps regardless of whether any sales were made

Proposed Cure Period for all Form D filings: One time per offering ability to cure a failure to correctly file Form D or amendment to Form D; must cure within 30 days of failure

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Changes to Form D

Item 2: Identification of issuer's publicly accessible website address

Item 3: Name and address of any person who directly or indirectly controls the issuer (Rule 506(c) offerings only)

Item 4: If issuer checks "other" box for industry group, new field will pop-up requesting clarification

Item 5: Issuer size, deletes "Decline to Disclose" and replaces with "Not Available to Public" –

- commentary suggest that if disclose in general solicitation materials, must disclose on Form D

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Changes to Form D

Item 6: Indication if relying on Rule 506(d) or Rule 506(c)

Item 7: Type of Filing, adds fields to check if Advance Form D or a closing Form D

Item 9: If securities of same class are publicly traded, must identify the trading symbol and generally available security identifier

Item 14: Investors, table requiring information on number of accredited investors and non-accredited investors that have purchased in the offering; whether they are natural persons or legal entities; amount raised from each category (Rule 506 offerings only)

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Changes to Form D

Item 16: Use of Proceeds – additional information on percentage of offering used for: (1) repurchase existing securities; (2) pay offering expenses; (3) acquire assets; (4) finance acquisitions; (5) working capital; and (6) discharge indebtedness (Rule 506 offerings by issuers which are not pooled investment funds only)

Item 17: Number of accredited investors who qualified as accredited investor on basis of: (1) income; (2) net worth; (3) director, executive officer or general partner; or (4) other basis (Rule 506 offerings only)

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Changes to Form D

Item 18: If traded on an exchange or registered under Exchange Act, name of exchange and/or SEC file number (Rule 506 offerings only)

Item 19: If used registered broker-dealer, whether general solicitation materials were filed with FINRA (Rule 506(c) offerings only)

Item 20: If pooled investment fund, name and SEC file number for registered adviser or exempt reporting adviser (Rule 506 offerings only)

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Changes to Form D

Item 21: Types of general solicitation used (e.g., mass mailings, e-mails, telephone solicitations, social media, etc.) (Rule 506(c) offerings only)

Item 22: Methods used to verify accredited investor status (e.g., documentation provided by third party, publicly available information, Form W-2, etc.) (Rule 506(c) offerings only)

Proposed Changes to Regulation D, Form D and Rule 156

Disqualification Amendments (Rule 507)

Current Rule: Disqualifies an issuer from using Reg. D if issuer, or predecessor or affiliate, has been enjoined by court for violating Form D filing requirements

Proposed Additional Rule: Issuer is automatically disqualified from using Rule 506 in any new offering for one year if issuer, or predecessor or affiliate, did not comply within past 5 years (or later adoption date of Rule 507(b)) with Form D filing requirements in a Rule 506 offering; one year period begins after properly filing required Form Ds for prior offering, or filing of closing Form D if prior offering has been terminated

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Disclosure Requirements (new Rule 509)

Legends Required on all written general solicitation materials (Rule 506(c) offerings only)

- securities sold only to accredited investors
- securities offered in reliance on exemption from registration requirements
- SEC has not passed on the merits of or given approval to the securities
- securities are subject to legal restrictions on transfer and resale
- investing in securities involves risk

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Disclosure Requirements (new Rule 509)

Disclosures Required on all written general solicitation materials prepared by private funds (Rule 506(c) offerings only)

- securities are not subject to protection of Investment Company Act
- if performance data included, legends disclosing that
  - data represents past performance
  - past performance does not guarantee future results
  - current performance may be lower or higher
  - not required by law to follow standard methodology when calculating performance
  - performance not directly comparable to performance of other funds

Proposed Changes to Regulation D, Form D and Rule 156

Proposed Disclosure Requirements (new Rule 509)

Disclosures Required on all written general solicitation materials prepared by private funds (Rule 506(c) offerings only)

- If performance data included:
  - telephone number or website where an investor can obtain current performance data
  - performance data must be as of most recent practicable data (e.g., last quarter end)
  - if fees and expenses not deducted, a statement that performance may be lower than presented

Proposed Changes to Regulation D, Form D and Rule 156

Submission of General Solicitation Materials (new Rule 510T)

- written general solicitation materials must be submitted to SEC no later than first use of the materials in the offering (Rule 506(c) offerings only)
- rule expires in 2 years
- not expected to be publicly available

Proposed Changes to Regulation D, Form D and Rule 156

Application of Rule 156 of Securities Act to Sales Literature of Private Funds

- Rule 156 currently applies to investment companies (e.g., mutual funds); proposal to have Rule 156 apply to all private funds
- Describes circumstances when sales literature may be misleading
- Statements are often deemed misleading because of what is not said or the lack of prominence given information that balances those statements (e.g., risk factors)
- Rule 156 particularly focused on statements about investment performance

Proposed Changes to Regulation D, Form D and Rule 156

Application of Rule 156 of Securities Act to Sales Literature of Private Funds

- Rule 156 currently applies to investment companies (e.g., mutual funds); proposal to have Rule 156 apply to all private funds
- Describes circumstances when sales literature may be misleading
- Statements are often deemed misleading because of what is not said or the lack of prominence given information that balances those statements (e.g., risk factors)
- Rule 156 particularly focused on statements about investment performance

Proposed Changes to Regulation D, Form D and Rule 156

Summary of Changes

- Form D filing prior to engaging in general solicitation
- Closing amendment to Form D upon termination of a Rule 506 offering
- Additional information fields on Form D
- One year disqualification for past failure to satisfy Form D requirements
- Legends and disclosures on general solicitation materials
- Submission of general solicitation materials to SEC
- Extension of Rule 156 to sales literature of private funds
- Comments on proposed rules due September 23, 2013

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QUESTIONS?

These materials are provided for general information only and do not constitute legal advice. For assistance with regard to any specific situation, please contact your Goodwin Procter LLP attorney.

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Commodity Futures Trading Commission (CFTC) Interaction

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August 1, 2013

When Should a VC Fund and its Manager Be Concerned with the CFTC?

- Last year the CFTC expanded the definition of commodity pool, commodity pool operator and commodity trading advisor.
- A fund, fund manager and/or its portfolio company that engage in "swaps" may be a commodity pool, commodity pool operator and/or a commodity trading advisor.
- Swaps include interest rate swaps, cross-currency rate swaps, currency swaps and commodity swaps. Foreign exchange swaps and foreign exchange forwards are generally exempt from the definition of swap.

Considerations

- Considerations at the VC Fund Level
  - Consider whether the fund hedges currency risk related to the value of a foreign company investment.
  - Consider whether the fund hedges credit risk related to a portfolio company's debt.
- Considerations at the Portfolio Company Level
  - Consider the nature of business of portfolio companies: non-financial companies should not cause issues. However, if a portfolio company enters into a swap, there may be issues if the fund manager provides advice to the portfolio company regarding the swap in connection with its participation in the management of the portfolio company.

Waiting for Revisions to CFTC Rules

- Many private funds currently rely on an exclusion from registration with the CFTC because their swap activity is below a certain threshold (aggregate margin, premium, security deposits for the swap transactions do not exceed 5% of the liquidation value of the fund's portfolio or the aggregate net notional value of the swap transactions does not exceed 100% of the liquidation value of the fund's portfolio). These private funds are still prohibited from marketing to the public in the US under CFTC rules which have not yet been revised to reflect the JOBS Act.
- Other private funds are registered with the CFTC but are exempt from certain disclosure requirements because they have certain qualified investors in their funds. These private funds cannot use the new offerings permitted by the JOBS Act under current CFTC rules.
- Barring action from the CFTC, these private funds will have to continue to refrain from marketing to the public in the US; withdraw their current exclusions/exemptions and register with the CFTC and comply with CFTC rules, or; drop the exclusions/exemptions, refrain from engaging in swap transactions and market to the public in the US.

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Thank you

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GENERAL SOLICITATION - POTENTIAL IMPACT ON PRIVATE ISSUER TRANSACTIONS

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August 1, 2013

secondmarket®

01 ELIMINATION OF BAN ON GENERAL SOLICITATION AND ADVERTISING

- SEC's final rules amend Rule 506 to permit issuers to generally solicit or generally advertise offerings of securities provided that each purchaser in the offering is, or is reasonably believed by the issuer to be at the time of sale, an accredited investor.

- Represents a sea change in the regulation of securities offerings:
  - Allows issuers to find potential investors more quickly and easily.
  - Issuers can now widely advertise or approach anyone with information about an offering – including by posting offering information on an unrestricted Internet website.
  - Eliminates restriction that private offers could be made only on the basis of a pre-existing relationship or observation of a waiting period following introduction (thus establishing a relationship).
  - More capital is raised under Regulation D than any other capital raising method, highlighting how impacts to capital markets may be significant.

- Amendments are effective on September 22, 2013.

02 REQUIREMENT FOR VERIFICATION OF ACCREDITED INVESTOR STATUS

- Issuers that choose to generally solicit or generally advertise must take reasonable steps to verify that all purchasers are accredited investors.
- What is “reasonable” is an objective test, based on the facts and circumstances of the transaction, the purchaser and the issuer. Factors an issuer should consider include:
  - Nature of the purchaser and the type of accredited investor that the purchaser claims to be;
  - Amount and type of information that the issuer has about the purchaser; and
  - Nature of the offering, including how the issuer located the potential investor, and the terms of the offering, such as a minimum investment amount.
- The SEC acknowledges the possibility that investors may provide issuers with false information in order to participate in an offering. In that situation, the SEC states its view that an issuer would not lose the ability to rely on Rule 506(c) so long as it had taken reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor at the time of sale.

03 HOW WILL MARKET PARTICIPANTS REACT?

- Private Companies
  - Early stage
  - Series A/B stage
  - Late stage
- Private Funds
  - General solicitation versus advertising
  - Branding opportunity
- Individual Investors
  - Privacy concerns
- Institutional Investors
- Investment Platforms (AngelList, Slated, CircleUp, Lending Club)
- Broker Dealers

04 POTENTIAL METHODS FOR VERIFICATION

- The SEC's final rules provide a non-exclusive list of methods that issuers can utilize to verify the accreditation of natural persons:
  - To verify net income, issuer must review most recent two years of tax returns (Forms W-2, 1099, K-1)
  - To verify net worth, issuer must determine assets by reviewing bank statements, brokerage statements, tax assessments and independent reports of appraisers, and determine liabilities by reviewing a credit report, all documents must be dated within the three months prior to the transaction.
  - If joint with spouse, review is also required of spouse's documentation.
  - Issuers must also obtain certain written representations:
    - Net income test – representation required that purchaser has reasonable expectation of earning enough income in current year to satisfy income test.
    - Net worth test – representation required that all liabilities necessary to determine net worth have been disclosed.
  - Issuer can obtain a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney, or certified public accountant that such entity or person has taken reasonable steps to verify the investor's accredited status **within the preceding three months**.
  - Issuer can obtain a certification of accredited status from existing shareholder who previously purchased securities from the issuer under Rule 506.
- Other methods of verification are acceptable, but not within safe harbor.

05 SECONDMARKET'S ACCREDITATION VERIFICATION PRODUCT

- SEC/FINRA registered broker-dealer
- Over 100,000 individuals and institutions have completed accreditation process under old rules through SecondMarket platform since 2010
- What is SecondMarket's General Solicitation Product?
  - Accumulation of investment interest
  - Individual investor accreditation
  - Institutional investor accreditation
  - Issuer report
  - Document execution
  - Transaction funding

06 MATERIALS

www.secondmarket.com/discover/learn/legal-learning-center

08 DISCLOSURES

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Areas of Practice

Jonathan Axelrad is a partner in the firm's Business Law Department and a member of its Private Investment Funds Practice. He joined Goodwin Procter in 2007.

Work for Clients

Mr. Axelrad specializes in all aspects of the formation and operation of venture capital and other private equity funds, with a particular emphasis on issues involving partnerships, limited liability companies, tax, ERISA, the Investment Advisers Act and the Freedom of Information Act. He has extensive experience in the areas of international fund structures and "market" terms and conditions. He has also been engaged as an expert witness in matters concerning the structure and operation of venture capital funds. Mr. Axelrad's practice has been devoted almost exclusively to fund services since 1996.

Professional Activities

Mr. Axelrad has been an active member of several American Bar Association and State Bar of California committees regarding tax, partnerships and limited liability companies. He has served as an Advisory Board member for *The Journal of State Taxation; Private Equity Partnership Terms and Conditions*, an Asset Alternatives report; and the *PE/VC Partnership Agreement Study 2010-2011*, published by Reuters.

Media and Presentations

Mr. Axelrad writes and lectures frequently on venture capital, tax, partnership and limited liability company issues. His publications include:

- Co-author, "Considerations for Private Funds After Lift of Ad Ban," *Securities Law360*, July 2013
- Co-author, “SEC’s New Rule: Implications for Fund Managers,” *Securities Law360*, September 2007
- Author, “New California Law Protects Confidentiality of Certain Fund Information,” 1 *Privacy & Data Security Law Journal* 147, January 2006
- Co-author, “Venture Fund Private Placement Memorandum,” a chapter in the third edition of *Venture Capital & Public Offering Negotiation*, Aspen Law & Business, 2003

- Co-author, “Limited Liability Companies,” a chapter in the fourth edition of *Marsh’s California Corporation Law*, Aspen Law & Business, 1999
- Co-author, “Tax Benefits Associated with Qualified Small Business Stock,” 2 *Venture Capital Review* 43, Spring 1998
- Co-author, “Distribution Provisions in Venture Capital Fund Agreements,” 1 *Venture Capital Review* 41, November 1997
- Author, “How Will Treasury’s Proposed Check-the-Box Regulations Affect Fund Agreements?” 36 *Venture Capital Journal* 8, August 1996
- Contributing Author, *Guide to Organizing and Operating a Limited Liability Company in California*, Partnerships and Unincorporated Business Organizations Committee of the Business Law Section of the State Bar of California, 1995
- Author, “Choice of Entity: Should You Use a C Corporation, S Corporation, or Limited Liability Company,” *Pratt’s Guide to Venture Capital Sources*, Securities Data Publishing, Inc., 1995
- Co-editor, *The Limited Liability Company: A New Form of Business Organization*, 1994
- Author, “Limited Liability Companies Finally Arrive for Venture Capital Firms,” 34 *Venture Capital Journal* 11, November 1994
- Author, “Securities Investment Partnerships: California Taxation of Nonresident Partners,” 12 *Journal of State Taxation* 72, Summer 1993
- Author, “Multi-tier Partnerships Can Pay General Partners for Results and Avoid Guaranteed Payments,” 10 *Journal of Taxation of Investments* 83, Winter 1993
- Author, “California Reduces Withholding Risks for General Partners of Venture Funds,” 32 *Venture Capital Journal* 10, October 1992
- Author, “Employee Partners: The Quest for Dual Status,” 1 *California Tax Lawyer* 3, Fall 1991

Professional Experience

Prior to joining Goodwin Procter, Mr. Axelrad was a partner in the Palo Alto office of Wilson Sonsini Goodrich & Rosati, where he led (and then co-led) that firm's fund services practice. Earlier in his career, he was an associate in the New York office of Sullivan & Cromwell.

Recognition

Mr. Axelrad has been selected for inclusion in *Chambers USA: America's Leading Lawyers for Business* (National Ranking for Venture Capital/Fund Formations) and *The Legal 500 U.S.*, and was named a "top dealmaker" by *AlwaysOn* magazine.

Education

- J.D., Yale Law School, 1987 (Claude R. Lambe Fellowship)
- B.A., Wesleyan University, 1984 (Phi Beta Kappa)

Bar and Court Admissions

Mr. Axelrad is admitted to practice in California.

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Areas of Practice

Thomas Beaudoin is a partner in the firm's Business Law Department and a member of its Private Investment Funds Practice. A leader in the field of fund formation, Mr. Beaudoin advises venture capital and private equity funds, and his clients include premier venture capitalists in the United States, Israel and other technology centers, as well as small and mid-sized private equity funds. He also represents institutional investors in the United States and abroad in their investments in all types of private investment funds. Mr. Beaudoin's clients include Canaan Partners, Khosla Ventures, Emergence Capital, Kreos Capital, Pitango Ventures, Carmel Ventures and WestView Capital. He joined Goodwin Procter in 2012.

Professional Activities

Mr. Beaudoin serves on the Advisory Board to Asset Alternatives' survey of "Private Equity Partnership Terms and Conditions," as well as on the Advisory Committee of The Association for Private Partnerships at Boston Private Bank & Trust Co. He is a member of the American Bar Association, the Massachusetts Bar Association and the Boston Bar Association.

Media and Presentations

Mr. Beaudoin is co-author of "Trends in the Private Equity Secondary Market," *Business Law Today* (March/April 2009) and "Indicators Point to a Busy Year for Venture Investors," *Boston Business Journal* (February 18, 2005).

He speaks frequently at private equity industry-sponsored events. Some of his more recent presentations include:

- Dow Jones PEA Webinar – "Raising a Fund in 2012: What LPs Want" (January 20, 2012)
- Boston Private Bank & Trust Company – "The Alternative Asset Landscape: An LP Perspective" (June 1, 2011)
- Dow Jones PEA Webinar – "Raising Capital From Public Pensions: What Firms Need to Know and Do" (April 14, 2011)
- American Conference Institute's 18th Private Equity Summit – "Trends in the GP & LP Relationship: Best Strategic Practices for Aligning Interests in Light of the Post-Recessionary Economy, Dodd-Frank and the ILPA Guidelines" (February 24, 2011)
- Private Equity Analyst Outlook Conference – "Raising a Fund in 2011: What Will it Take?" (January 25, 2011)

- The Institutional Limited Partners Association (ILPA) Members Only Fall Conference – "The Limited Partner Advisory Committee 201: What You Need to Know Now and For The Future" (September 29, 2010)
- Dow Jones PEA Webinar – "Getting to a First Close: What Does It Take" (September 17, 2010)
- Vintage Venture Partners Third Israeli Private Equity and Venture Capital Summit – "Regulatory Update and Terms and Trends in Limited Partnership Agreements" (October 28, 2009)

Professional Experience

Prior to joining Goodwin Procter in 2012, Mr. Beaudoin was partner at WilmerHale, where he chaired its Fund Formation Practice Group. Previously, he was partner at Testa, Hurwitz & Thibeault.

Recognition

Mr. Beaudoin has been recognized as a Massachusetts leader in the private equity field in *Chambers USA: America's Leading Lawyers for Business*. He was named a "Leading Lawyer" in the area of investment fund formation and management: venture capital funds in 2009 edition of *The Legal 500 United States*, as well as a "New England Super Lawyer" in corporate law from 2008-2011 by *Boston* magazine. He is listed in Legal Media Group's 2008 *Guide to the World's Leading Private Equity Lawyers*, in the 2008 and 2011 editions of *Who's Who Legal: The International Who's Who of Private Funds Lawyers*, and in *Best Lawyers in America*, from 2006-2012, in the area of private funds law. Mr. Beaudoin has been consistently recognized for his exceptional private equity practice in *Chambers Global: The World's Leading Lawyers*, and he has been listed in each edition of *Who's Who Legal: The International Who's Who of Business Lawyers* since 2004.

Education

- J.D., The George Washington University Law School, 1986
- B.A., Boston University, 1978 (*cum laude*)

Bar and Court Admissions

Mr. Beaudoin is admitted to practice in Massachusetts.

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Areas of Practice

Anthony McCusker, a partner and co-chair of the firm's Technology Companies Practice, specializes in all areas of corporate, securities and partnership laws, with a primary focus on the formation and financing of emerging growth companies. Mr. McCusker serves as Chair of Goodwin Procter's Silicon Valley office and is a member of the firm's Executive Committee. He is a key contributor to the Goodwin Procter Founders Workbench, an online resource for start-ups, emerging companies and the entrepreneurial community. He joined Goodwin Procter in 2010.

Work for Clients

Mr. McCusker's representation of companies spans the entire corporate life-cycle, including pre-incorporation planning, general corporate representation and counseling, venture capital financings, public offerings, joint ventures, and mergers and acquisitions. He also works with venture capitalists, private equity investors and investment banks involved in private and public stock offerings.

Professional Experience

Prior to joining Goodwin Procter, Mr. McCusker was a partner in the Silicon Valley office of Gunderson Dettmer.

Recognition

Mr. McCusker has been selected for inclusion in *Chambers USA: America's Leading Lawyers for Business* and *The Best Lawyers in America*. He was recently featured in the Daily Journal as one of the top emerging law firm leaders in California.

Education

- J.D., University of California Hastings College of the Law, 1995
- B.A., University of California, Berkeley, 1992

Bar and Court Admissions

Mr. McCusker is admitted to practice in California.

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Areas of Practice

Brynn Peltz is a partner in Goodwin Procter's Business Law Department and a member of the Financial Institutions Group's Transactions and Investment Management & Regulation Practices, as well as the firm's Private Investment Funds Practice.

Work for Clients

Ms. Peltz has more than 20 years' experience advising financial institutions (such as private equity, real estate and hedge fund sponsors; alternative asset managers; business development companies; and registered investment companies) on strategic matters, including with respect to all aspects of the Investment Advisers Act of 1940 and the Investment Company Act of 1940.

Her work includes fund formation, registration and offerings, structuring of financial products, adviser registration and compliance, as well as mergers and acquisitions in the investment management sector. She also has a deep knowledge of exchange-traded funds and other structured wealth management products with fund characteristics.

Professional Activities

Ms. Peltz is a member of the Association of the Bar of the city of New York Investment Management Regulation Committee and the Women's Investment Management Forum.

Professional Experience

Prior to joining Goodwin Procter in 2013, Ms. Peltz was a corporate partner in the New York office of Latham & Watkins. Previously, she was a partner at Clifford Chance.

Recognition

Ms. Peltz has been recognized for her work with investment funds in both the *Chambers USA* and *Legal 500 US* guides.

Education

- J.D., Cornell Law School, 1988
- B.A., Cornell University, 1985

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Areas of Practice

Brad Weber is a partner in the firm's Business Law Department and a member of the Technology Companies, Capital Markets and Clean Tech Practices. He joined Goodwin Procter in 2007.

Mr. Weber represents public and private technology companies, as well as venture capital firms, private equity firms and investment banking clients focused on technology companies, in securities and capital markets transactions, mergers and acquisitions, venture capital financings and general corporate matters. He represents companies in all stages of development, from start-up ventures to Fortune 1000 companies, and investors and investment banking clients of all sizes.

He has particular experience representing and advising clients in the technology industry (including software, digital media, e-commerce, SaaS), the clean tech industry (including solar, wind, energy storage, biofuels, biochemicals, transportation, green agriculture, energy efficiency and advanced materials) and the life sciences industry (including biotechnology and medical devices).

Professional Activities

Mr. Weber is a member of the American, California, New York and San Diego Bar Associations.

Professional Experience

Prior to joining Goodwin Procter, Mr. Weber was an associate in the Corporate Department at Heller Ehrman LLP. Before that, he was an associate in the Corporate Department at Cravath, Swaine & Moore LLP.

Recognition

While attending law school, Mr. Weber was a member of the *Columbia Science & Technology Law Review*.

Education

- J.D., Columbia Law School, 2002 (Harlan Fiske Stone Scholar)
- B.A., Princeton University, 1999 (*magna cum laude*)

Bar and Court Admissions

Mr. Weber is admitted to practice in California and New York.