SHARTSIS FRIESE LLP
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September 19, 2013

VIA E-MAIL

To Our Investment Adviser Clients and Other Friends

Re: Rule 506 "Bad Actor" Disqualification from 506 Safe Harbor

On July 10, 2013, the SEC adopted rules prohibiting the use of Rule 506 of Regulation D ("**Rule 506**") for any securities offering involving certain "bad actors" (the "**Rule**"). We addressed the Rule in our letter dated August 2, 2013. This letter reminds advisers that manage private funds of actions to consider soon, given that the Rule goes into effect on Monday, September 23, 2013 (the "**Effective Date**").

If a person covered by the Rule (a "**Covered Person**") has experienced a "Disqualifying Event" enumerated under the Rule before the Effective Date, an adviser must disclose such facts to potential fund investors. If a Covered Person experiences a Disqualifying Event after the Effective Date, an adviser may not rely on Rule 506 to offer fund interests unless the adviser did not know, and through the exercise of "reasonable care," could not have known, about the Disqualifying Event. Of particular importance to most private fund advisers are the following Covered Persons:

a. each fund's directors, general partners, managing members, executive officers (key personnel) and other officers who participate in the applicable offering;

b. each finder and solicitor, and its general partners, directors, managing members, executive officers and other officers who participate in the applicable offering;

c. each investment adviser and its general partners, managing members, executive officers and other officers who participate in the applicable offering; and

d. affiliated funds, which includes any fund under common control with the fund whose interests are being offered.

The SEC requires advisers to engage in a factual inquiry into bad acts by Covered Persons, but has not identified what procedures are sufficient to constitute "reasonable care." The level of inquiry required to meet the standard depends on factors such as the degree of regulation affecting the Covered Person, the adviser's familiarity with the Covered Person, and the degree of other screening and compliance methods already in place at the adviser. The

reasonable care standard is lower with respect to regulated entities, such as registered broker-dealers. Advisers must periodically update their factual inquiries through contractual bring-down representations, new questionnaires or negative consent letters. To demonstrate "reasonable care," an adviser should consider:

1. Updating, if necessary, employee questionnaires to ask about each Disqualifying Event. The adviser should obtain new questionnaires from employees, and employees should be required to notify the adviser promptly of any changes to their responses and to provide updated questionnaires periodically.

2. Obtaining completed certificates or questionnaires from solicitors and finders regarding any Disqualifying Events. A representation from a solicitor or finder certifying that no general partner, director, managing member, or applicable officer has had a Disqualifying Event will likely be sufficient. New solicitor and finder agreements may need to be updated to include the necessary certificates or questionnaires, bring-down representations and requirements that such solicitors or finders update their questionnaires periodically.

3. Obtaining completed questionnaires from the directors of each offshore fund.

4. Reviewing the adviser's capital structure to confirm that no outside investor has the ability to direct the adviser's management and policies. If such an investor exists, the adviser should obtain a completed questionnaire from each fund or other issuer that the outside investor "controls."

5. Reviewing U.S. and offshore funds' governing documents to determine whether investors have the ability to control or significantly influence the management of those funds. If a fund's investors have that ability, the fund's interests or shares might be deemed "voting securities," and any investor that holds more than twenty percent of such voting securities would be a Covered Person. Rights such as the ability to remove the fund's general partner or directors, or to approve significant transactions (such as acquisitions, dispositions or financings) might be sufficient to cause interests or shares to be deemed voting securities. If a fund offers voting securities, the adviser should obtain a completed questionnaire from each investor that holds more than twenty percent of any class of voting securities regarding the Disqualifying Events.

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This letter only generally summarizes action items in preparation for the September 23, 2013, effective date for the Rule, is not intended as specific or complete advice, and is subject to change as best practices develop. For further assistance, including assistance updating your finders and solicitors agreements, policies and procedures and questionnaires, please contact Doug Hammer, John Broadhurst, Geoff Haynes, Chris Rupright, Carolyn Reiser, Neil Koren, Jim Frolik, Christina Hamilton, Joan Grant, Ellyn Roberts, Anthony Caldwell or David Suozzi.

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