

**The Investment Company Act of 1940:**  
**Preserving The Definitional Exceptions to Investment Company Registration.**

**The Investment Company Act and Non-Public Offerings**

The Investment Company Act of 1940 (“ICA’40”) provides for two exceptions from registration for hedge funds under Section 3(c)(1) and 3(c)(7), both of which require that the offering of limited partnership interests/securities under such Section be non-public in nature. However, the ICA’40 does not define what constitutes a “public offering.” Instead, when the Securities and Exchange Commission adopted Regulation D, it made clear that an offering which complies with Section 4(2) or Rule 506 under the Securities Act of 1933 (the “Securities Act”) is compatible with the ICA’40.

**What Constitutes a Public Offering**

Rule 502(c) defines a public offering as any advertisement, article, notice, or other communication in any newspaper, magazine, or similar media as well as radio and television broadcasts. Any form of mass communication, such as “blind” mailings, newspaper ads, press releases, spam e-mail, etc. are also covered. Additionally, the definition includes any seminar or meeting whose attendees have been invited by general solicitation or advertising.

Unfortunately, the prohibition on general solicitation and advertising is by its nature inherently subjective because it depends upon the “facts-and-circumstances” surrounding an offering, which are often unclear. For example, mentioning a private fund in an interview with a publication could be considered a form of general solicitation, even though the fund’s manager had no intention of promoting the fund; therefore, many managers are careful to avoid specifically mentioning any fund names or details in interviews or press releases.

**The Pre-Existing Relationship Requirement**

Historically, the SEC has interpreted Rule 502’s prohibition on general solicitation or advertising to require the fund issuer to have had a substantive relationship with the prospective purchaser prior to the commencement of the offering, referred to commonly as a “pre-existing relationship.” This relationship is important to enable the issuer to be aware of and evaluate the financial circumstances and sophistication of the potential purchaser before any offer is made.

One of the most common ways the pre-existing relationship requirement can be satisfied is through a prior investment or other business dealings with the potential purchaser. Additionally, the relationship can be created by having potential purchasers respond to a questionnaire that provides the issuer with sufficient information to evaluate the purchasers’ sophistication and financial circumstances. In any event, a pre-existing relationship generally involves at least some degree of contact between the issuer and the prospective purchaser prior to the offering.

---

For Further Information:

Also, to some degree a pre-existing relationship needs to exist between the issuer and any third parties through which the issuer hopes to make an offering; this includes the scenario where an issuer makes a mass mailing of information about a private placement to broker-dealers, lawyers, accountants, or other professionals, with whom the issuer has no pre-existing relationship, for redistribution by these third parties to their clients.

### **Use of the Internet**

A web site created by an issuer may collect questionnaires from potential investors and, upon the potential investors being qualified as “accredited investors,” provide those potential investors with a password enabling them to access private fund information on the web site. However, in such situations, purchases may only be made 30 or more days after the potential investor is deemed to be qualified.

### **Judicial Review**

The most common factors that courts have looked at in determining whether an offering was public include: the number of purchasers; the sophistication of the purchasers; whether a pre-existing relationship had been formed; whether purchasers could gain access to information directly from the manager, and; the precautions taken to prevent purchasers from reselling their interests. To protect one’s self from litigation, the manager should build a one-on-one relationship with each purchaser, make a preliminary inquiry into the purchaser’s ability to assume the financial risks involved in acquiring an interest, and always make themselves available to the purchaser for further information and inquiry.

### **Dissemination of the PPM**

One of the best ways a fund manager can maintain the private nature of their offering is through controlling the dissemination of the fund’s private placement memorandum (“PPM”). Each copy of the PPM transmitted by the manager to an investor should be numbered and the manager should keep a record of all recipients. Prospective investors should be reminded that dissemination of the PPM to other investors is prohibited. In the event that an investor decides not to invest in the fund, the manager should request that the PPM be returned to the fund.

### **Disclaimers on Communications**

It is advisable that a disclaimer substantially similar to the one below be attached to all written client communications, regardless of the format:

THIS [COMMUNICATION] IS SUBMITTED TO YOU ON A CONFIDENTIAL BASIS SOLELY IN CONNECTION WITH YOUR CONSIDERATION OF AN INVESTMENT IN LIMITED PARTNERSHIP INTERESTS IN [FUND]. DUE TO THE CONFIDENTIAL NATURE OF THIS [COMMUNICATION], ITS USE

---

For Further Information:

**BILAL H. MALIK:** 678.279.5478 or [bilal.malik@maliklawgroup](mailto:bilal.malik@maliklawgroup) OR **DEVLIN H. DWYER:** 678.279.5494 or [devlin.dwyer@maliklawgroup.com](mailto:devlin.dwyer@maliklawgroup.com)

FOR ANY OTHER PURPOSE MIGHT INVOLVE SERIOUS LEGAL CONSEQUENCES. CONSEQUENTLY, THIS [COMMUNICATION] MAY NOT BE REPRODUCED IN WHOLE OR IN PART, AND MAY NOT BE DELIVERED TO ANY PERSON (OTHER THAN YOUR FINANCIAL ADVISOR) WITHOUT THE PRIOR WRITTEN CONSENT OF [GENERAL PARTNER].

### **Case-By-Case Advice**

Malik Law Group offers ongoing advice in any matter which might arise involving a question of a public versus a private offering. Your compliance with the law is our highest priority, and our firm will assist you in any way possible to keep your fund operating within the exceptions provided by the ICA'40 and the Securities Act. Do not hesitate to contact us with any compliance related question or issue.

*This memorandum is intended to inform Malik Law Group's clients of certain legal matters and is not intended as legal advice. You should consult a lawyer before taking any action based on the information contained above. Please contact Malik Law Group with any questions or comments you may have about this memorandum.*

---

For Further Information:

**BILAL H. MALIK:** 678.279.5478 or [bilal.malik@maliklawgroup](mailto:bilal.malik@maliklawgroup) OR **DEVLIN H. DWYER:** 678.279.5494 or [devlin.dwyer@maliklawgroup.com](mailto:devlin.dwyer@maliklawgroup.com)