Private Equity Regulatory Update

August 31, 2017

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Rules and Regulations

SEC's Acting Director of OCIE Says Private Equity May Be Less of a Priority Ahead

The SEC's Acting Director of Office of Compliance Inspections and Examinations ("OCIE"), Peter Driscoll, recently noted that the SEC likely will not continue to blanket most private equity firms for potential regulatory violations. Driscoll noted that, "I think we've hit that area pretty hard. Generally we are going to focus more on retail investors." Nonetheless, we believe that it is important not to overread this statement. Any shift in emphasis at the SEC may take some time to be felt, and we believe that private equity firms still should expect continued SEC attention.

SEC Confirms That Some Initial Coin Offerings Are Illegal Unregistered Securities Offerings

On July 25, 2017, the SEC issued a Section 21(a) report of its investigation into an offering of digital tokens by "The DAO," an unincorporated virtual organization. Though declining to take enforcement action against The DAO, the SEC used this much-anticipated opportunity to warn others engaged in similar activities that an unregistered sale of blockchain tokens can, depending on the circumstances, be an illegal public offering of securities. Simultaneously, the SEC issued a bulletin warning investors about such sales, often called "initial coin offerings" or ICOs. The DAO 21(a) report focused on a fact-pattern where the classic test for a "security" under federal law, announced in the Supreme Court's 1946 case *SEC v. W.J. Howey Co.*, was easily met: the tokens were sold for value and represented ownership interests in a common enterprise; the purchasers had an expectation of profit from the efforts of others; and the tokens were distributed in a manner that bore the hallmarks of a traditional securities offering. In a recent Client Memorandum, we explore further the DAO ICO, situations where ICO tokens may be considered securities and implications for the token ecosystem.

- ▸ See a copy of the memorandum

DOL Takes Steps to Delay Certain Aspects of the Fiduciary Rule, but Key Rules for Funds Remain

According to recent court filings and actions by the Office of Management and Budget ("OMB"), the U.S. Department of Labor ("DOL") has taken new steps to delay the full applicability date of its **fiduciary rule** and related exemptions. If the DOL's intended delay comes to fruition, which is not certain, requirements that are currently delayed until January 1, 2018 will be further delayed 18 months until July 1, 2019. The expanded definition of "fiduciary investment advice" that went into effect on June 9 is still applicable and the potential delay relates only to certain onerous requirements under the Best Interest Contract ("BIC") Exemption and other exemptions proposed under the new rule to help certain retail financial service providers operate under their expanded fiduciary role. The proposed delay does not impact the aspects of the rule that apply to private funds' communications with benefit plan investors and retail IRAs.

On August 9, 2017, in a case challenging the DOL's fiduciary rule, the DOL filed a **notice of administrative action** notifying the court that the DOL had filed with the OMB a proposed amendment that would delay the applicability date of currently delayed requirements of the BIC Exemption and two other exemptions by 18 months. **Our prior blog post** describes which requirements are currently applicable and which requirements are currently delayed until January 1, 2018 (and potentially delayed until July 1, 2019).

On August 29, 2017, the OMB accepted the DOL's proposed delay. The next step is for the DOL to publish the text of its delay in the Federal Register. If and when the DOL's administrative action is published, we will have a better understanding of the future of the fiduciary rule. While it is not certain, at this point, it seems likely that there will be some form of delay.

Industry Update

ILPA's Letter to Treasury on Private Equity Regulation

On July 28, the Institutional Limited Partners Association ("ILPA") submitted a letter to the U.S. Department of the Treasury regarding the President's February 2017 Executive Order on Core Principles for Regulating the U.S. Financial System (the "Executive Order"). ILPA's letter contends that the current regulatory environment for private equity advisers is appropriately tailored both to achieve the Executive Order's objectives and also to satisfy the Executive Order's requirements that regulations be "efficient, effective, and appropriately tailored." In other words, in ILPA's view, there should be no moves to reduce the regulatory burdens currently imposed on private equity investment advisers. In making its case, ILPA asserts that increased regulation has strengthened capital formation in the private equity industry. The American Investment Council ("AIC") filed its own comment letter on this topic in June, in which it made the case for reducing the regulatory burdens faced by private equity investment advisers.

- **See a copy of ILPA's letter**
- **See a copy of AIC's letter**
- **See a copy of the Executive Order**

Litigation

Delaware Supreme Court's Ruling in *DFC Global* Provides Important Clarity on the Role of Deal Price and the Sale Process in Appraisal Proceedings

The Delaware Supreme Court, in an opinion by Chief Justice Strine, recently reversed and remanded the Chancery Court's ruling in *DFC Global Corporation v. Muirfield Value Partners, L.P.*, an appraisal

proceeding to determine the fair value of DFC Global following its acquisition by the private equity firm Lone Star Funds. In recent appraisal decisions, including *DFC Global* and *In re Appraisal of Dell, Inc.*, the Chancery Court declined to rely on the deal price as the best evidence of fair value, notwithstanding a robust sale process. This was due, in part, to flaws that the Chancery Court determined to exist in the ability of the market to establish a fair price. These decisions resulted in appraisal values meaningfully in excess of the deal price, creating significant uncertainty for buyers and sellers in the M&A market. *DFC Global*, a highly anticipated opinion by the Delaware Supreme Court, provides important clarity over the role of the deal price and the sale process in Delaware appraisal proceedings. The Delaware Supreme Court will also have an opportunity to provide further clarity on the role of deal price and the sale process in appraisal proceedings in its upcoming review of the Chancery Court's decision in *Dell*. The *Dell* proceedings will therefore continue to be worth monitoring.

In a recent Client Memorandum, we outline the key elements of the Delaware Supreme Court's decision in *DFC Global*, and its implications for buyers and sellers in future M&A transactions.

- **See a copy of the opinion**
- **See a copy of the memorandum**

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