



SEC Disqualifies "Bad Actors" from Rule 506 Offerings

Proposes Amendments to Form D, Regulation D and Rule 156

By: Susan Fisher, Charles C. Reeder and Whit Roberts

Disqualification of "Bad Actors" from Rule 506 Offerings

On July 10, 2013, the Securities and Exchange Commission (the "SEC") adopted a final rule to implement a prohibition on the use of the exemption from registration provided by Securities Act Rule 506 of Regulation D for any offering in which certain felons and other bad actors are involved. The disqualification of "bad boys" from Rule 506 offerings is required pursuant to Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Dodd-Frank instructs the SEC to issue disqualification rules for Rule 506 offerings that are substantially similar to the bad actor disqualification provisions currently contained in Regulation A. The SEC's final rule is generally consistent with the proposed rule issued on May 25, 2011, and amends Rule 506 by including new paragraph (d). The new Rule 506(d) covers the following persons: (i) the issuer and any predecessor of the issuer or affiliated issuer; (ii) directors, executive officers, officers participating in the offering, general partners and managing members of the issuer; (iii) 20% beneficial owners of the voting equity securities of the issuer (calculated on the basis of voting power); (iv) promoters; (v) investment managers and principals of pooled investment funds; and (vi) persons compensated for soliciting investors as well as the general partners, directors, officers and managing members of any compensated solicitor. This alert refers to persons covered by this new rule as "covered persons."

Under the new rule, an issuer cannot rely on a Rule 506 exemption from registration if the issuer or any other covered person listed above had a "disqualifying event." These "disqualifying events" include the following:

- Criminal convictions in connection with the purchase or sale of a security or involving the making of false filings with the SEC or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;
- Court injunctions and restraining orders in connection with the purchase or sale of a security or involving the making of false filings with the SEC or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;
- Final orders from certain state governmental authorities, federal banking agencies, the CFTC and the National Credit Union Administration that (i) bar the covered person from associating with a regulated entity or engaging in the business of securities, insurance or banking or in savings association or credit union activities or (ii) are based on fraudulent, manipulative or deceptive conduct;
- Certain SEC disciplinary orders;
- Certain SEC cease-and-desist orders;
- Certain SEC stop orders;
- Suspension or expulsion from membership in a self-regulatory organization; and
- U.S. Postal Service false representation orders.

The final rule provides an exception from disqualification when the issuer can show that it did not know, and in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering. Such exception preserves the intended benefits of Rule 506 by reducing the risk that issuers could lose the benefit of a Rule 506 exemption as a result of disqualifications they did not know about.



Also note that the new disqualification provisions only apply to "disqualifying events" that occur after the effective date of the new rule. Any pre-existing matters that would otherwise be disqualifying are subject to mandatory disclosure to investors.

Currently, issuers may seek waivers of disqualification under Regulation A if the issuer shows good cause. The new rule carries over the current waiver provisions of Regulation A. Further, the new rule allows the SEC to grant a waiver from disqualification if, before the Rule 506 offering is made, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing that disqualification should not arise as a consequence of such order, judgment or decree.

Amendments to Form D Pursuant to Rule 506(d)

Pursuant to new Rule 506(d), the signature block of Form D will contain a certification whereby issuers claiming a Rule 506 exemption will confirm that the offering is not disqualified from reliance on Rule 506 for one of the reasons stated in Rule 506(d).

Proposed Amendments to Private Offering Rules

On the same date that the SEC adopted new Rule 506(d) and its related amendments to Form D described above in this alert, the SEC also adopted final rules to eliminate the long-standing prohibition on general solicitation in connection with private securities offerings under Rule 506 and Securities Act Rule 144A. View the companion release by [clicking here](#). Due to the lifting of the ban on general solicitation, the SEC has issued a proposal for a number of amendments to Regulation D, Form D and Rule 156 of the Securities Act. These proposed amendments are intended to enhance the SEC's ability to assess developments in the private placement market in light of the new rules. The proposed rules would improve the SEC's ability to understand and evaluate the Rule 506 market and would address numerous concerns raised by investors.

With regards to Form D and Regulation D, the SEC proposes the following:

- Amending Rule 503 to require the filing of an advance notice of sale 15 days before the use of general solicitation pursuant to Rule 506(c) and within 30 days after the conclusion of an offering;
- Amending Form D to require additional information about the issuer and the offering, including identification of the issuer's website, the offered securities, the types of investors, the use of the proceeds, the types of general solicitation used and the methods used to verify accredited investor status;
- Amending Rule 507 to disqualify an issuer from using Rule 506 for one year in any new offering if the issuer (or any predecessor or affiliate) failed to file a Form D in a Rule 506 offering in the past;
- Issuing new Rule 509 requiring certain legends and disclosures in written general solicitation materials used in a Rule 506(c) offering;
- Issuing Rule 510T to require issuers, on a temporary basis, to submit any written general solicitation materials to the SEC; and
- Amending Rule 156 to extend guidance about misleading statements in sales literature by a registered investment company to private funds whether or not engaged in general solicitation activities.

The proposal is subject to a 60-day public comment period beginning on the date after the proposal is published in the Federal Register.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

Susan Fisher | 214-740-8538 | sfisher@lockelord.com
Charles C. Reeder | 214-740-8522 | creeder@lockelord.com
Whit Roberts | 214-740-8659 | wroberts@lockelord.com