



September 2013

CORPORATE ADVISORY

The Securities and Exchange Commission ("SEC") recently amended (i) Rules 501 and 506 of Regulation D of the Securities Act of 1933, as amended (the "Securities Act"), and (ii) Form D in order to fulfill its obligation under Section 962 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the so-called JOBS Act), which required the SEC to adopt rules to prevent felons and other "bad actors" from being involved in Rule 506 offerings ("Bad Actor Rules"). The following persons are subject to the Bad Actor Rules ("Covered Persons"), which became effective on September 23, 2013:

- (a) the issuer, its predecessors and affiliate issuers;
- (b) any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- (c) any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- (d) any promoter connected with the issuer in any capacity at the time of such sale;
- (e) any investment manager of an issuer that is a pooled investment fund;
- (f) any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities;
- (g) any general partner or managing member of any such investment manager or solicitor; or
- (h) 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.

A Covered Person will be disqualified from Rule 506 offerings if it is involved in any of the following disqualification events ("Disqualifying Events"):



- (a) Criminal convictions in connection with the purchase or sale of a security or the 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 five (5) years of the proposed sale of securities in the case of the issuer, its predecessors, and affiliated issuers, and within ten (10) years of the proposed sale of securities in the case of other covered persons.
- (b) Court injunctions and restraining orders in connection with the purchase or sale of a security or the 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 (5) years of the proposed sale of securities.
- (c) Final orders of the Commodities Futures Trading Commission, federal banking agencies, the National Credit Union Administration, or state regulators of securities, insurance, banking, savings associations, or credit unions that (1) bar the issuer from (i) associating with a regulated entity; (ii) engaging in the business of securities, insurance, or banking; or (iii) engaging in savings association or credit union activities; or (2) are based on a violation of any law or regulation prohibiting fraudulent, manipulative, or deceptive conduct and that were issued within ten (10) years of the proposed sale of securities.
- (d) Certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisers and their associated persons.
- (e) SEC cease-and-desist orders that were issued within five (5) years before the sale of securities and that ordered the Covered Person to cease and desist from committing or causing a violation or future violation of any scienter-based anti-fraud provision of the federal securities laws or Section 5 of the Securities Act.
- (f) SEC stop orders and orders suspending the Regulation A exemption that were issued within five (5) years of the proposed sale of securities and pending investigations or proceedings to determine whether a stop order or suspension order should be issued.
- (g) Suspension or expulsion from membership in a self-regulatory organization ("SRO") or from association with an SRO member.



- (h) U.S. Postal Service false representation orders that were issued within five (5) years before the proposed sale of securities and temporary or preliminary injunctions with respect to conduct alleged by the U.S. Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

Disqualification of a Covered Person shall continue for the period in which conduct is either prohibited or required pursuant to an order. Disqualification of a Covered Person only applies, however, for Disqualifying Events that occur after the effective date of the Bad Actor Rules—*i.e.*, on or after September 23, 2013. However, an issuer is required under the Bad Actor Rules to disclose in writing any matter(s) that would have triggered disqualification under the Bad Actor Rules, except for the fact that the Disqualifying Event(s) occurred prior to September 23, 2013.

The amendments also provide an exception to the disqualification of a Covered Person if the issuer can establish that it did not know, and that in the exercise of reasonable care it could not have known, that a "Bad Actor" participated in the issuer's offering. In other words, the issuer will be subject to a facts-and-circumstances test to determine whether it exercised reasonable care in confirming that all of its Covered Persons are not subject to any Disqualifying Events at the time of the offering. Prudent issuers will therefore conduct a factual inquiry before any offering by requiring directors, officers and other Covered Persons to complete "Bad Actor" questionnaires.

Finally, in amending Form D, the SEC has added a certification in the issuer's signature block for such form, so that the issuer attests that its offering under Rule 506 is not disqualified from reliance on Rule 506 under the Bad Actor Rules.

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If you would like to discuss any of these issues further or have any questions as to what might be the best type of guaranty for you and why, please contact Mark Hobson, Esq. at Devine Goodman Rasco Watts-FitzGerald & Wells, P.A.