



## Bad Boy Rules and Regulation D

The SEC is proposing new regulations under the Section 926 of the Dodd- Frank Wall Street Reform and Consumer Protection Act. The Rule is officially know as the **Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings**. These rules are similar to the rules provided for in Rule 505, Regulation A, Regulation E and state limited offering exemptions.

“Bad actor” disqualification requirements, sometimes called “bad boy” provisions, prohibit issuers and others (such as underwriters, placement agents and the directors, officers and significant shareholders of the issuer) from participating in exempt securities offerings if they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. Rule 506 in its current form does not impose any bad actor disqualification requirements. In addition, because securities sold under Rule 506 are “covered securities” under Section 18(b)(4)(D) of the Securities Act, state-level bad actor disqualification rules do not apply.

The disqualifying events include:

- felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission within the last five years in the case of issuers and ten years in the case of other covered persons;
- injunctions and court orders within the last five years against engaging in or continuing conduct or practices in connection with the purchase or sale of securities, or involving the making of any false filing with the Commission;
- U.S. Postal Service false representation orders within the last five years;
- Filing, or being or being named as an underwriter in, a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order should be issued, or as to which a stop order was issued within the last five years; and
- Final orders issued by state securities, banking, credit union, and insurance regulators, federal banking regulators, and the National Credit Union Administration that either

- bar a person from association with an entity regulated by the regulator issuing the order, or from engaging in the business of securities, insurance or banking, or from savings association or credit union activities; or
- are based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within a ten-year period.

The proposed rule would cover the issuer, its predecessors, and affiliated issuers, as well as:

- directors, officers, general partners, and managing members of the issuer;
- 10 percent beneficial owners and promoters of the issuer; and
- persons compensated for soliciting investors, as well as the general partners, directors, officers, and managing members of any compensated solicitor.

The comment period for the proposed rule expires July 14, 2011. Interestingly, the proposed rule does not have any phase-in period before compliance would be required. There have been some commentators that argue that these prohibitions would make it more difficult for issuers to raise money using Reg. D. But I have to agree with other commentators that ultimately these rules strengthen the faith in the use of Reg. D. and the addition of this rule is a good thing.