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ALERT MEMORANDUM

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Private Offerings: SEC Liberalizes the Rules but also Proposes New Requirements

On July 10, 2013, the Securities and Exchange Commission adopted rule changes that:

- permit general solicitation and general advertising in private securities offerings made in reliance on Rule 506 or Rule 144A under the Securities Act;[1] and

- make Rule 506 unavailable for an offering if "bad actors" are involved – i.e., if the issuer or other relevant persons have been the subject of specified disqualifying events involving securities fraud or certain other violations of law.[2]

These rules are final and will take effect 60 days after publication in the Federal Register. Each action fulfills a specific Congressional mandate – the first under the 2012 JOBS Act and the second under the 2010 Dodd-Frank Act. Both actions were widely expected, as the Commission under new Chair Mary Jo White tackles a long list of unfinished business to implement the JOBS Act and the Dodd-Frank Act.

The rule changes to allow general solicitation represent a major change in how private offerings can be conducted, and the Commission expects them to have a significant impact on capital-raising practices. The liberalization is intended to facilitate capital formation, but it has also been the subject of extensive commentary arguing that it could lead to an increase in fraudulent activity and in sales of unregistered securities to unqualified investors. Commissioner Aguilar, who voted against the adoption of the rule changes, summarized these arguments at the Commission's July 10 meeting and in a written statement.[3] Recognizing these concerns, the Commission has directed its staff to execute a work plan to monitor market practices in offerings conducted with general solicitation.

The Commission also proposed a series of rule changes that would, if adopted, impose significant new requirements on Rule 506 offerings that are conducted with general solicitation.[4]

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1 The rule changes permitting general solicitation and general advertising are set forth in a Commission release dated July 10, 2013, which is available at http://www.sec.gov/rules/final/2013/33-9415.pdf.

2 The rule changes disqualifying "bad actors" are set forth in a Commission release dated July 10, 2013, which is available at http://www.sec.gov/rules/final/2013/33-9414.pdf.

3 Commissioner Aguilar's statement, titled "Facilitating General Solicitation at the Expense of Investors," is available at http://www.sec.gov/news/speech/2013/spch071013laa-1.htm.

4 The proposed rule changes are set forth in a Commission release dated July 10, 2013, which is available at http://www.sec.gov/rules/proposed/2013/33-9416.pdf. Commissioners Gallagher and Paredes voted against this proposal.

These relate primarily to Form D, the information form that must be filed with the SEC in connection with a private offering under Regulation D, and to materials used for general solicitation. The Commission also proposed to expand the scope of Rule 156 – which interprets the antifraud provisions of the federal securities laws in connection with sales literature used by registered investment companies – to apply it to private investment funds as well as registered investment companies.

The rule changes to permit general solicitation in private offerings implement Section 201(a) of the JOBS Act, enacted in April 2012. Section 201(a) directed the SEC to revise Rules 144A and 506 (two "safe harbor" rules for private offerings under the Securities Act) within 90 days to liberalize restrictions on publicity. The SEC initially proposed rule changes in August 2012, but controversy surrounding the proposed rules resulted in a delay. The final rules are essentially the same as the August 2012 proposal, with one exception – the addition of a safe harbor identifying certain non-exclusive means of verifying that a natural person is an accredited investor.

The rule changes to disqualify offerings involving "bad actors" from relying on the Rule 506 safe harbor implement Section 926 of the Dodd-Frank Act, enacted in July 2010. The SEC originally proposed revisions to Rule 506 in May 2011, but these were delayed when the JOBS Act required further revisions to the rule. In response to comments, the final revisions have been modified in some respects generally to ease their impact.

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I. Revised Rule 144A

Section 201(a) of the JOBS Act required the SEC to amend Rule 144A to permit offers to persons other than qualified institutional buyers, or QIBs (as defined in Rule 144A), provided the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs. Rule 144A is a safe harbor that permits a person other than the issuer to resell securities without registration if the transaction meets specified conditions. Prior to the revision, one of the conditions was that the securities be *offered* or *sold* only to persons the seller and any person acting on the seller's behalf reasonably believe are QIBs. As a result, Rule 144A effectively prohibited general solicitation.

Revised Rule 144A will no longer refer to "offers" and "offerees" in the conditions to be met under paragraph (d)(1) of Rule 144A. Consequently, after the revised rule becomes effective, a seller will be permitted to rely on Rule 144A even if the securities are offered to non-QIBs and even if there has been general solicitation.

Although Rule 144A is not available for offerings by issuers, the rule is frequently used to permit banks to resell securities purchased from an issuer for immediate resale. The issuer's sale to the banks ordinarily relies on Section 4(a)(2) of the Securities Act, while the resale relies on Rule 144A. The adopting release confirms that the use of general solicitation in the second step will not affect the availability of the Section 4(a)(2) exemption for the initial sale. (The new rules generally do not affect offerings under Section 4(a)(2), as further discussed in Section II below.)

The adopting release also reaffirms the guidance in the proposing release that offers made outside the United States pursuant to Regulation S will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 506 or Rule 144A. We believe this statement means that, as in the case of other permissible activities in connection with an SEC-registered or exempt U.S. offering, the use of general solicitation or general advertising for the U.S. offering does not bear on whether there have been directed selling efforts in connection with the Regulation S offering, which are separately prohibited by Regulation S.

II. New Rule 506(c) – Private Offerings with General Solicitation

Rule 506 is a safe harbor for private offerings by issuers. As it stands prior to the July 10 revisions, it provides that offers and sales by an issuer to an unlimited number of "accredited investors" and up to 35 other investors are exempt from registration under Section 4(a)(2) of the Securities Act so long as certain conditions are met. One of the conditions is that neither the issuer nor any person acting on its behalf may offer or sell the securities by any form of "general solicitation" or "general advertising."

Section 201(a) of the JOBS Act directed the Commission to revise Rule 506 to permit general solicitation and general advertising in offerings under the rule, provided that all purchasers of the securities are accredited investors and that the rule must "require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission."

The new rule leaves the existing safe harbor under Rule 506 unchanged, and redesignates it as Rule 506(b). It adds a new paragraph 506(c), under which a private offering may make use of general solicitation and general advertising. The conditions for an offering under Rule 506(c) differ from those under Rule 506(b) in five respects.

- The requirement that there be no general solicitation or general advertising does not apply in a Rule 506(c) offering.

- All purchasers in a Rule 506(c) offering must be accredited investors. The adopting release emphasizes that this requirement is not absolute, because it is met if the issuer and those acting on its behalf have a reasonable belief that each investor is an accredited investor. The definition of accredited investor includes *both* persons that actually fall in specified categories *and* persons the issuer reasonably believes fall in the specified categories.

- The issuer must check a box on Form D to indicate that it is relying on either Rule 506(b) or Rule 506(c). Form D is the notice required to be filed by an issuer that offers or sells securities in reliance on any of the Regulation D exemptions, including Rule 506. Some comments on the proposed rule suggested that an issuer might check both boxes – for example, if general solicitation is contemplated but might not be used, or to protect against losing the exemption as a result of inadvertent solicitation. The adopting release specifies that the issuer must check one box or the other. It would appear, however, that an issuer can amend a Form D for an offering to select 506(b) after having selected 506(c) in a prior Form D filing for that offering or vice versa.

- In a Rule 506(b) offering, certain information concerning the issuer must be furnished to any investor other than accredited investors. In a Rule 506(c) offering, only accredited investors may participate, so this information requirement does not apply.

- In a Rule 506(c) offering, the issuer must take "reasonable steps to verify" that the purchasers are accredited investors. This is an independent procedural requirement, and it must be met even if in fact all the purchasers happen to be accredited investors.

This requirement of "reasonable steps to verify" was the subject of extensive comment and is discussed at length in the adopting release. The release explains that this is a "principles-based" requirement, resting on "an objective determination, based on the particular facts and circumstances of each transaction." Issuers should consider a number of factors, and the release discusses three examples: the nature of the purchaser, the information the issuer has about the purchaser, and the nature and terms of the offering.

The final rule includes one significant element that was not in the proposal: a safe harbor for specified methods to verify the accredited investor status of natural persons. This was adopted in response to comments expressing concern that the rule should provide for greater certainty about the availability of the safe harbor. The addition of the safe harbor was widely sought in the comment process and is consistent with the SEC's decades-long practice of providing safe harbors from Section 5 violations in light of the draconian consequences (in particular, a strict liability "put" or rescission right for purchasers).

Specifically, Rule 506(c) provides a non-exclusive list of methods to verify accredited investor status for natural persons that will be deemed to satisfy the verification requirement. These are: (a) review of specified documentation showing that a person meets the income test in the definition of accredited investor;[5] (b) review of specified documentation showing that a person meets the net worth test;[6] (c) reliance on written confirmation from a third party that it

[5] The verification requirement is met if the issuer reviews specified IRS forms showing the requisite income level for the two most recent years and obtains a written representation from the potential investor that he or she has a reasonable expectation of reaching the requisite income level during the current year.

[6] The verification requirement is met if the issuer reviews specified types of documentation of the potential investor's net worth and obtains a written representation from the potential investor that all liabilities necessary to make a determination of net worth have been disclosed.

has verified the person's accredited investor status;[7] and (d) reliance on certification from an existing investor who previously invested in the issuer's Rule 506(b) offering. The issuer may not rely on the safe harbor if it or its agent has knowledge that the purchaser is not an accredited investor.

Private placements conducted without the use of general solicitation or advertising may proceed exactly as before. For example, a Rule 506(b) offering, which is not permitted to use general solicitation, may still include up to 35 investors that are not accredited investors, as long as the information requirement of Rule 502(b) is met. There is no separate requirement of "reasonable steps to verify" the status of participating accredited investors in a Rule 506(b) offering, but an issuer should, as before, take steps to support the reasonable belief requirement under the definition of accredited investor in case a purchaser in the offering turns out not to be in one of the categories of investors in that definition.

The new rule does not affect private offerings made under the statutory exemption in Section 4(a)(2) of the Securities Act. The adopting release states that "[a]n issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption will be restricted in its ability to make public communications to solicit investors for its offering because public advertising will continue to be incompatible with a claim of exemption under Section 4(a)(2)."

III. Proposed Changes to Regulation D, Form D and Rule 156

On July 10, the SEC also proposed a number of new rules and rule changes applicable to private offerings, especially under new Rule 506(c). These proposals are being made to address investor protection concerns, raised in numerous comments on the August 2012 proposal, about anticipated changes in practices, types of issuers, investors solicited, intermediaries and the amount of capital raised in Rule 506(c) offerings. Many of them are intended to enhance the Commission's ability to evaluate the development of market practices in Rule 506 offerings and to address concerns that may arise in connection with permitting issuers to engage in general solicitation under Rule 506(c).

1. Proposed Changes to Disclosure Items in Form D

Under Rule 503, an issuer offering or selling securities in reliance on Rules 504, 505 or 506 currently must file with the SEC a notice of sales on Form D no later than 15 calendar days after the first sale of securities in the offering. The proposal seeks to revise Form D to require certain additional disclosure items, some of which would apply to all Regulation D offerings and some of which would apply only to Rule 506(c) offerings. The most notable of the proposed changes would require issuers relying on Rule 506(c) to disclose (a) the methods of general solicitation used, (b) the methods used to verify accredited investor status of the purchasers and (c) the persons directly or indirectly controlling the issuer.

[7] The third party may be a broker-dealer, an investment adviser, an attorney, or a certified public accountant.

2. Rule 503 – Advance and Closing Form Ds

The SEC has proposed amending Rule 503 to require issuers intending to offer securities under Rule 506(c) to file Form D with the Commission at least 15 calendar days prior to "any general solicitation activities" (an "Advance Form D"). General solicitation activities are not defined in the adopted rules or otherwise,[8] and commenters may seek increased clarity on this issue, especially given the consequences of failure to file timely a Form D, as discussed below. The Commission notes in the proposing release that the impetus for the filing of Advance Form D is to allow it to gather information about Rule 506(c) offerings. The Advance Form D would require an issuer to complete a subset of the items required by Form D.

An issuer could file an Advance Form D without describing (or even contemplating) specific offering activities that might constitute general solicitation, in order to have the flexibility to conduct an offering using general solicitation. Such an approach would, however, identify an issuer considering a Regulation D offering before that might otherwise be required. In practice, the requirement to file Advance Form D could be a speed bump that issuers will consider in deciding whether to take advantage of the Rule 506(c) accommodations. We expect that commenters will question whether the additional time provided to regulators by requiring Advance Form D is outweighed by the potential impediment to capital raising created by the requirement, possibly suggesting a compromise that accelerates the Form D filing to not later than the first use of general solicitation (but in any event not later than 15 days after the first sale).

The Commission also proposes to amend Rule 503 to require issuers to file a final amendment to Form D (a "Closing Form D") with the SEC no more than 30 calendar days after termination of any Regulation D offering, whether under Rule 506(c) *or* Rule 506(b). The proposing release states that the current rules requiring the filing of Form D only after the first sale of securities preclude the SEC from determining whether some offerings are ultimately unsuccessful, and that including both 506(b) and 506(c) offerings in the requirement would allow the SEC to better monitor private placement practices under Regulation D generally.

The proposed rules with respect to Form D would have the effect of requiring an issuer relying on Rule 506(c) to file Form D three times – an Advance Form D 15 days prior to using general solicitation, an amendment 15 days after the first sale in the offering and a Closing Form D 30 days after the termination of the offering. An issuer relying on Rule 506(b) would be required to file Form D twice, unless it included all the required information in the first filing.

3. Rule 507(b): One-Year Disqualification for Failure to File Form D

While the filing of Form D is a requirement under Rule 503, it is not a condition for use of the Regulation D safe harbor. Rule 507 disqualifies an issuer from relying on the Regulation D

[8] In the adopting release for Rule 506(c), the Commission acknowledges that the terms "general solicitation" and "general advertising" are not defined in Regulation D, but refers to the following sources of guidance: Rule 502(c), which provides examples of general solicitation and general advertising and interpretations where the Commission has confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising.

safe harbor prospectively if the issuer, or a predecessor or affiliate, has been enjoined by a court for violating the filing requirements of Rule 503.

The proposing release refers to the suggestion by several commenters that the SEC require compliance with Rule 503 as a condition to use of Rule 506, or at least to use of Rule 506(c). It acknowledges, however, that doing so could result in a violation of Section 5 of the Securities Act (and the availability of a strict liability "put" or rescission right for the purchasers under Section 12(a)(1) of the Securities Act) and applicable state securities laws for the entire offering, a result the Commission believes to be disproportionate to the failure to file.

The SEC proposes amending Rule 507 to add a new subsection (b), which would disqualify an issuer from using Rule 506(c) prospectively if it has failed to file a Form D, including any of the successive amendments required under the proposed rules, in connection with a previous Rule 506(b) or Rule 506(c) offering, in each case after expiration of a 30-day cure period for late filings. The disqualification would apply to an issuer that had failed to make such a filing in the prior five years. The rule would permit an issuer to remedy the disqualification by making the filings it missed, in which case it would become eligible to use Rule 506 again one year after making the corrective filings.

Disqualification would arise only in the case of missed filings that occur after the effectiveness of new Rule 507(b). The proposal provides that the Commission may waive this disqualification through delegated authority to the Director of the Division of Corporation Finance, as under existing Rule 507.

4. Rule 509: Legend and Content Requirements for General Solicitation Materials

The SEC has proposed the adoption of new Rule 509 of Regulation D, which would establish (a) a legend requirement for all general solicitation and general advertising materials and (a) additional disclosure requirements for advertising materials used by private funds.

The legend for all general solicitation materials would require an issuer to disclose that:

- the securities may be sold only to accredited investors, which for natural persons, are investors who meet certain minimum annual income or net worth thresholds;
- the securities are being offered in reliance on an exemption from the registration requirements of the Securities Act and are not required to comply with specific disclosure requirements that apply to registration under the Securities Act;
- the Commission has not passed upon the merits of or given its approval to the securities, the terms of the offering, or the accuracy or completeness of any offering materials;
- the securities are subject to legal restrictions on transfer and resale and investors should not assume they will be able to resell their securities; and

- investing in securities involves risk, and investors should be able to bear the loss of their investment.

Private fund legends would also need to disclose (a) that the securities being offered are not subject to the protections of the Investment Company Act of 1940 and (b) limitations on the usefulness of performance data, if such data is included in general solicitation materials. In addition, private funds using performance data in their solicitation materials would be required to disclose certain information regarding such performance data and provide access to current performance data.

The proposal also disqualifies from relying on Rule 506(b) or (c) any issuer, predecessor to or affiliate of the issuer that has been subject to any order, judgment or court decree enjoining that person for failure to comply with Rule 509.

The proposal does not address the use of legends in communications where they might not be readily practicable, such as for example communications involving certain social media.

5. *Rule 510T: Submission of Solicitation Materials to the SEC*

The SEC has proposed temporarily requiring all issuers that use written general solicitation or advertising materials in Rule 506(c) offerings to submit those materials to the Commission no later than the date of first use. This rule as proposed would expire two years after its effective date. The proposing release notes that the rule is intended to allow the SEC to understand what practices develop with respect to solicitation materials. These materials would not be filed via EDGAR, would not be made public and would not be treated as being "filed" or "furnished" for purposes of the Securities Act or Exchange Act, including the liability provisions of those Acts. (It is unclear, however, whether such materials could still potentially be obtained from the SEC pursuant to the Freedom of Information Act (FOIA).)

To allow the Commission to assess market developments prior to the adoption of proposed Rule 510T, the submission page will be open upon the effectiveness of Rule 506(c) for the voluntary submission of written solicitation materials used in Rule 506(c) offerings until Rule 510T is adopted.

The proposal includes a disqualification from the use of Rule 506(b) or (c) that would be similar to that under proposed Rule 509 for issuers that are subject to an order, judgment or decree enjoining a person for failure to comply with Rule 510T.

6. *Rule 156: Antifraud Provision for Sales Literature Extended to Private Funds*

The SEC has proposed amending Rule 156 – which prohibits the use of materially misleading sales literature by registered investment funds – to include sales literature used by private funds as well.

The proposing release also explicitly solicits comment on whether it should propose additional rules addressing manner and content restrictions on written general solicitation materials used by private funds.

7. Other Items

In addition to proposing the new rules and rule amendments described above, the SEC stated in the proposing release that it has directed its staff to undertake a comprehensive work plan to review and analyze market practices resulting from eliminating the prohibition on general solicitation for Rule 506(c) offerings. The staff will (a) examine methods of accredited investor verification used by issuers, (b) analyze whether sales to non-accredited investors increase following the effectiveness of Rule 506(c), (c) examine the information submitted to the SEC on Form D and any general solicitation materials submitted voluntarily prior to the effectiveness of proposed Rule 510T, (d) monitor Rule 506(c) offerings for increased incidence of fraud, (e) incorporate an evaluation of Rule 506(c) practices in examinations of registered broker-dealers and registered investment advisers and (f) coordinate with state securities regulators on sharing information about Rule 506(c) offerings.

The SEC staff has also begun a review of the definition of accredited investor as it relates to natural persons, and the proposal requests comment on that definition.

As Commissioner Paredes pointed out, in a statement accompanying his dissent from the issuance of the proposed rules for comment, one question that the proposals raise is whether they will effectively inhibit the use of general solicitation and general advertising for Rule 506(c) offerings, pursuant to the rules mandated by the JOBS Act and adopted on July 10. We anticipate that the scope of the proposed rules will result in a significant amount of comment in this area.[9]

IV. New Rule 506(d) – Bad Actor Disqualification

New Rule 506(d) removes the protection of the Rule 506 safe harbor from offerings in which a "bad actor" (as described in more detail below and in the attached Appendix) participates. The new rule is generally consistent with the proposal made in May 2011, but it differs in several respects generally intended to ameliorate its impact. In particular, adopted Rule 506(d) modifies the scope of persons whose conduct is covered by the rule, revises the originally proposed disqualifying events in certain respects, and exempts from the ambit of the rule disqualifying events that took place before the effective date of the adopted rule.

In the proposing release, the SEC asked for comments on the feasibility of making potential additional changes to its rules (in particular Rule 505 of Regulation D, Regulation A and Regulation E) to make "bad actor" disqualification more uniform across other exemptive rules. The adopting release states that, at this time, the SEC has determined not to make any additional changes to other rules, but that it is continuing to consider the issue and may propose such changes in the future.

[9] Commissioner Paredes' statement is available at http://www.sec.gov/news/speech/2013/spch071013tap.htm.

1. *Covered Persons*

The disqualification provisions apply to the following categories of persons:

- the issuer, any predecessor, any affiliated issuer and any promoter;
- any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- any beneficial owner of 20% or more of the issuer's outstanding voting equity securities;
- with respect to an issuer that is a pooled investment fund, any investment manager of the issuer;
- any person paid (directly or indirectly) to solicit purchasers in connection with sales in the offering (*e.g.*, a placement agent);
- with respect to any such investment manager or solicitor, (i) any general partner or managing member and (ii) any director, executive officer or other officer participating in the offering of the investment manager, the solicitor or a general partner or managing member of the investment manager or solicitor.

Compared to the rule as originally proposed, the scope of persons whose conduct is implicated by the rule has been narrowed in certain respects but expanded in others. The most significant change is that where the proposed rule addressed conduct by "officers" generally, the final rule more narrowly addresses conduct only by "executive officers" and "officers participating in the offering."[10] Also, where the proposed rule set the test for shareholders at 10% or more of any outstanding class of the issuer's voting equity securities, the final rule sets it at 20% or more of the issuer's outstanding voting equity securities, calculated on basis of voting power. The scope of adopted Rule 506(d) was, however, expanded for pooled investment funds to include investment managers, their general partners and managing members, and the respective directors, executive officers and participating officers of such managers, general partners and managing members.[11]

[10] Rule 506(d) does not define what it means for an officer to be "participating in the offering." According to the adopting release, however, participation in an offering would be more than transitory or incidental involvement, and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents, and communication with the issuer, prospective investors or other offering participants.

[11] The SEC also considered, but determined not to make any changes to, the definition or coverage of promoters, noting that promoters represent a broad category of persons that captures all individuals and entities that have relevant relationships with the issuer or to the offering, and that those relationships must be analyzed on a look-through basis.

2. *Disqualifying Events*

The disqualifying events in final Rule 506(d) are substantially consistent with those initially proposed, subject to limited changes in response to comments. Disqualifying events include:

- criminal convictions in connection with purchases or sales of a security, making false filings with the SEC or that arise from conducting business as an underwriter, broker-dealer, investment adviser or paid solicitor;
- injunctions and court orders related to engaging in or continuing conduct or practices relating to such activities;
- final orders of certain federal and state regulators that either bar a person from engaging in securities, insurance, banking or similar activities (or from association with an entity regulated by the regulator issuing the order), or that are based on a violation of any law or regulation prohibiting fraudulent, manipulative, or deceptive conduct;
- SEC cease-and-desist orders arising from a violation of Section 5 of the Securities Act or scienter-based antifraud provisions of the federal securities laws;
- certain other SEC orders (including suspension, revocation of registration or limitations on activities as a broker-dealer or investment adviser);
- suspension, expulsion or being barred from association with a national securities exchange or association for improper conduct;
- filing or being named as an underwriter in a registration statement as to which a stop or suspension order was issued, or being the subject of an investigation to determine whether such an order should be issued; or
- U.S. Postal Service false representation orders and certain temporary restraining orders or injunctions.

The time periods for disqualification generally address conduct arising from between five and ten years prior to the date of the Rule 506 sale, although in certain cases a person will only be disqualified if the injunction, order, investigation or similar event is in effect and continuing at the time of the Rule 506 sale. For additional information, see the Appendix to this memorandum.

In a significant change from the proposing release, final Rule 506(d) limits disqualification to triggering events that occur *after* effectiveness of the rule, although the issuer will still be required to disclose past disqualifying events to purchasers in advance of sales under Rule 506 (unless the issuer can establish that it did not know and reasonably could not have known of the existence of those past disqualifying events). Although this will still require issuers to determine whether any pre-adoption disqualifying events exist for purposes of disclosure, the change should help to address at least some of the concerns raised by commenters as to market participants who may have voluntarily entered into consent decrees or who would otherwise be disqualified based on prior conduct, but who were not in a position to know of the consequences under revised Rule 506.

Rule 506(d) also includes a waiver provision, under which a waiver of disqualification may be granted upon a showing of good cause. Unlike the proposing release, which required that any such waiver be granted by the Commission itself, the rule as adopted delegates waiver authority to the Director of the Division of Corporation Finance. The final rule also permits any court or regulatory authority that enters an order, judgment or decree that would cause an actor to be disqualified under the rule to advise the SEC that, in its view, disqualification under Rule 506 should not arise as a consequence of such order, judgment or decree, and in such circumstances disqualification will not arise.[12] That waiver will be effective even without a separate waiver from the SEC, if it was made before the relevant Rule 506 sale.

3. Reasonable care

Rule 506(d) sets out a "reasonable care" exception, under which an issuer will not lose the benefit of the Rule 506 safe harbor, despite the existence of a disqualifying event, if it can show that it did not know and, in the exercise of reasonable care, could not have known of the disqualification. The adopting release indicates the issuer will be expected to conduct a factual inquiry to rely on this exception, and makes clear that the steps an issuer must take to be deemed to have exercised "reasonable care" will vary according to the particular facts and circumstances.[13] The release notes issuers will likely have in-depth knowledge of their own directors and officers, and that additional inquiry "by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient in some circumstances, particularly if there is no information or other indicators suggesting bad actor involvement." The release also notes the SEC's expectation that market participants, such as placement agents and broker-dealers, will develop procedures to assist issuers in gathering the necessary information. Finally, for continuous, delayed or long-lived offerings, the release notes that the requirement to exercise reasonable care will include updating the factual inquiry on a "reasonable" basis, but that, in appropriate cases, periodic updating should suffice. (A similar "reasonable care" exception applies to the requirement of disclosure of pre-effective date events that would otherwise be disqualifying events.)

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Please feel free to call any of your regular contacts at the Firm or any of our partners and counsel listed under "Capital Markets" or "Corporate Governance" in the Practices section of our website (http://www.clearygottlieb.com) if you have any questions.

[12] The notice provided by the court or regulatory agency can either be in the relevant order, judgment or decree or in a separate writing to the Commission or its staff.

[13] The adopting release states that issuers "should consider the totality of the offering taking into account the circumstances of the offering, the covered persons involved in the offering and the rule's requirements, which include specific disqualifying events and covered persons subject to those disqualifying events." This will enable issuers to "determine their own methodology for a factual inquiry," which helps to promote efficiency because it enables the issuer "to tailor its own inquiry without adherence to uniform standards that may not be applicable or appropriate in the context of a particular issuer or particular offering."

APPENDIX

Disqualifying Events and Relevant Dates Under Rule 506(d)

- *Criminal Convictions*. Felony and misdemeanor convictions (a) in connection with the purchase or sale of a security, (b) involving the making of a false filing with the SEC or (c) arising out of the conduct of the business of an underwriter, broker, dealer, investment adviser or paid solicitor, if occurring within the five years (in the case of issuers) or ten years (in the case of other covered persons) before the Rule 506 sale.

- *Court Injunctions and Restraining Orders*. Injunctions and court orders against engaging in or continuing conduct or practices (a) in connection with the purchase or sale of a security, (b) involving the making of a false filing with the SEC or (c) arising out of the conduct of the business of an underwriter, broker, dealer, investment adviser or paid solicitor, if issued within the five years before the Rule 506 sale.

- *Final Orders of Certain Federal and State Regulators*. Final orders issued by federal banking regulators, the Commodity Futures Trading Commission (the "CFTC"), the National Credit Union Administration or state securities, banking, credit union or insurance regulators that (a) bar a person from engaging in securities, insurance, banking, saving association or credit union activities, or from association with an entity regulated by the regulator issuing the order, if in effect at the time of the Rule 506 sale or (b) are based on a violation of any law or regulation prohibiting fraudulent, manipulative, or deceptive conduct, if entered within the ten years before the Rule 506 sale. In adopting this provision, the SEC added the CFTC to the list of relevant regulators whose regulatory bars and other final orders trigger disqualification, and also modified the definition of "final order" to require that the proceeding under which the order was issued have provided for both notice and an opportunity for a hearing.[14]

- *SEC Cease-and-Desist Orders*. Cease-and-desist orders issued by the SEC based on a violation of (a) any scienter-based anti-fraud provision of the federal securities laws[15] or (b) Section 5 of the Securities Act (which does not require scienter), if entered within the five years before the Rule 506 sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of the laws above. This provision represents a new disqualification trigger that was not included in the proposing release. In the adopting release, the SEC noted its belief that screening

[14] With respect to the prong of Rule 506(d) that would require determining whether there has been "fraudulent, manipulative, or deceptive conduct", the SEC considered, but did not adopt, a scienter requirement; accordingly, the final rules neither define such conduct, nor do they limit such conduct to matters involving scienter. The adopting release notes that this decision was, in part, based on the fact that some regulators may not require scienter in determining whether fraudulent, manipulative, or deceptive conduct has taken place, and that imposing such a limit could result in the exclusion of orders that were explicitly mandated to be covered by amended Rule 506.

[15] These provisions include, without limitation, Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 15(c)(1) of the Exchange Act and Section 206(1) of the Advisers Act.

out bad actors should not depend on whether a particular enforcement action is brought in a court or through an SEC administrative proceeding, and that excluding cease-and-desist orders from an investor protection rule that separately includes federal judicial proceedings and orders by state and other federal regulators that address the same kinds of conduct could lead to asymmetry in applying Rule 506 disqualification standards.

- *SEC Disciplinary Orders and Certain Actions Relating to a Securities Self-Regulatory Organization*. Certain SEC orders (including suspension or revocation of registration as a broker, dealer, or investment adviser, or imposing limitations on such activities) or suspension or expulsion from, or being barred from association with, a national securities exchange or national securities association for "conduct inconsistent with just and equitable principles of trade," if in effect at the time of the Rule 506 sale.

- *Stop Orders and Regulation A Suspension Orders*. Being named as an underwriter in, or filing, a registration statement or a Regulation A offering statement as to which a stop order or suspension order was issued within the five years before the Rule 506 sale, or being the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued, if such investigation or proceeding is taking place at the time of the Rule 506 sale.

- *U.S. Postal Orders*. U.S. Postal Service false representation orders entered within the five years before the Rule 506 sale, or being subject, at the time of such sale, to certain U.S. Postal Service temporary restraining orders or injunctions.

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