

Private Equity Alert

SEC Issues Guidance on Regulation D “Bad Actor” Rules

By David Wohl and Venera Ziegler

On December 4, 2013, the Division of Corporation Finance of the Securities and Exchange Commission (the **SEC**) issued new Compliance and Disclosure Interpretations (the **Interpretations**) regarding Rules 506(d) and (e) of Regulation D under the Securities Act of 1933, which rules prevent issuers from conducting private placements that rely on Rule 506 if felons and other bad actors participate in the offering.*

Below is a summary of certain of the Interpretations that may be of interest to private fund sponsors. To access the full list of Interpretations, please see questions 260.14 to 260.27 on the SEC’s website at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

Definition of “Affiliated Issuer”

- Under Rule 506(d), an issuer may be disqualified from relying on Rule 506 if an “affiliated issuer” is a bad actor. The Interpretations clarified that an “affiliated issuer” is an affiliate of the issuer that is issuing securities in the same offering. In the private fund context, an affiliated issuer generally will mean a parallel investment vehicle of the issuer, but not other affiliates under common control with the issuer or controlled portfolio companies of the issuer.

Exercising Reasonable Care

- An issuer may reasonably rely on a covered person’s agreement to provide notice of a potential or actual bad actor triggering event pursuant to, for example, contractual covenants or an undertaking in a questionnaire or certification. However, the issuer must update its factual inquiry periodically for a long-lasting or continuous offering. The SEC listed several methods for updating the diligence process to ensure compliance with the reasonable care standard of Rule 506(d) depending on facts and circumstances, such as a bringdown of representations, questionnaires and certifications, negative consent letters, and periodic rechecking of public databases. Therefore, under certain circumstances, obtaining negative consent (rather than an affirmative response) from a covered person as to the lack of a disqualifying event could be sufficient to establish reasonable care.

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 - Weil advised Avista Capital Partners and Nordic Capital in connection with their joint offer for Swiss-listed pharmaceuticals company Acino
 - Weil advised The Jordan Company in its acquisition of Watchfire Enterprises, Inc., a manufacturer of LED signs and digital billboards, from Harbour Group
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- The reasonable care exception applies not only to the failure to discover a disqualifying event, but also when, despite the exercise of reasonable care, an issuer was unable to determine that a particular person was a covered person or initially reasonably determined that the person was not a covered person but subsequently learned that such determination was incorrect. Such issuer will still need to consider what steps are appropriate upon discovery of Rule 506(d) disqualifying events

and covered persons throughout the course of an ongoing offering.

Placement Agents and Other Solicitors

- If a placement agent becomes subject to a disqualifying event under Rule 506(d) during an offering, an issuer may continue to rely on Rule 506 for future sales of that offering if the engagement with that placement agent is terminated and the placement agent does not receive compensation for future sales.
- An issuer is required to disclose bad acts occurring prior to September 23, 2013 with respect to a compensated solicitor who is involved with the offering at the time of sale to all investors, not just investors who were solicited by the solicitor that committed the bad act.
- An issuer is required to disclose bad acts occurring prior to September 23, 2013 with respect to a compensated solicitor who is involved with the offering at the time of sale. However, disclosure with respect to a compensated solicitor who is no longer involved with the offering is not required in order for the issuer to be able to rely on Rule 506.

Sanctions by Foreign Entities

- Convictions, court orders, injunctions in a foreign court, regulatory orders issued by a foreign regulatory authority, and other actions taken in foreign jurisdictions are not disqualifying events under Rule 506(d).

Waiver of Disclosure Obligation

- The obligation of the issuer to disclose bad acts occurring prior to September 23, 2013 in accordance with Rule 506(e) is not subject to waiver by the SEC.

Please do not hesitate to contact us with any questions.

* For more information on the bad actor rules, please see our July 2013 Private Equity Alert "SEC Adopts Final Rules Permitting General Solicitation in Private Offerings" available at http://www.weil.com/files/upload/Private_Equity_Alert_July_2013_.pdf

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