

The SEC Rule 506 'Bad Actor' Final Rules

Written By **E. Knox Proctor V** (ekp@wardandsmith.com)

September 19, 2014



The new "bad actor" rules promulgated by the Securities and Exchange Commission ("SEC") in Rule 506 require issuers to take "reasonable care" to verify that no "disqualifying events" -- from a long list of securities and financial violations -- have occurred with respect to the issuer or any of the following persons related to the issuer:

- Directors, key officers, general partners, and managing members;
- Beneficial owners of more than 20% of the ownership interests in the issuer;
- Promoters;
- Investment managers and principals of pooled investment funds; and,
- Persons paid for soliciting investors and their general partners, directors, officers, and managing members.

Checking whether all these people have committed "bad acts" will impose significant new burdens, potential liabilities, and significant risks on issuers of Rule 506 offerings. This is especially the case where one or more finders, investment banks, or investment pools are involved in the deal, because they have many affiliated people who will have to be investigated.

Likewise, the inclusion of "promoters" will cast a shadow on any deal. It can be difficult to determine who is a promoter, because past events can make someone who currently plays no significant active role in the issuer a "promoter." While SEC rules have always called for some disclosures about promoters, the bad actor rules will require issuers to devote more attention to the concept than in the past.

The primary penalty the rules specifies is that the issuer cannot use Rule 506 as an exception for its offering while the "bad actor" is affiliated with it or its investment banker.

--

© 2022 Ward and Smith, P.A. For further information regarding the issues described above, please contact E. Knox Proctor V.

This article is not intended to give, and should not be relied upon for, legal advice in any particular circumstance or fact situation. No action should be taken in reliance upon the information contained in this article without obtaining the advice of an attorney.

We are your established legal network with offices in Asheville, Greenville, New Bern, Raleigh, and Wilmington, NC.

