

June 2011

INVESTMENT MANAGEMENT UPDATE

SEC Proposes to Disqualify Felons and Other “Bad Actors” from Rule 506 Offerings

In accordance with Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission (SEC) recently proposed amendments to Rules 501 and 506 of Regulation D and Form D under the Securities Act of 1933¹ (“Securities Act”). The proposed rules would disqualify certain securities offerings involving felons and bad actors from reliance on the safe harbor exemption.

The rules, which would impact hedge funds, private equity funds and private placements, would impose a new burden of inquiry with respect to potential disqualifying events.

OVERVIEW

Rule 506 permits an unlimited dollar amount of securities to be sold without registration to an unlimited number of accredited investors and up to 35 non-accredited investors as long as there is no general solicitation, appropriate resale limitations are imposed, any applicable information requirements are satisfied and the other conditions of the rule are met.²

Rule 506 in its current form does not impose any bad actor disqualification requirements and since the securities are “covered securities” under Section 18(b)(4)(D) of the Securities Act, no state-level bad actor disqualification rules apply.

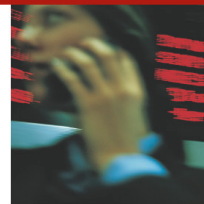
REQUIREMENTS OF THE PROPOSED RULE

Under the proposed rule, an offering would be unable to rely on the Rule 506 exemption if the issuer or any other person covered by the rule had a “disqualifying event.”

Covered Persons

The proposed rules would include the following as “covered persons”:

- The issuer, including its predecessors and affiliated issuers
- Any director, officer, general partner or managing member of the issuer
- Any beneficial owner of 10 percent or more of any class of the issuer’s equity securities
- Any promoter connected with the issuer at the time of the sale



- Any person who has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering
- Any director, officer, general partner or managing member of compensated solicitors

Disqualifying Events

Under the proposed rules, a “disqualifying event” would include the following:

Criminal Convictions

Any covered person has been convicted of a felony or misdemeanor:

- In connection with the purchase or sale of a security
- Involving making a false filing with the SEC
- Arising from business conducted by an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities

The conviction must have occurred within 10 years of the sale of securities (or five years, in the case of the issuer and its predecessors and affiliated issuers).

Injunctions and Court Orders

Any covered person is subject to any order, judgment or decree of any court of competent jurisdiction that restrains or enjoins such person from engaging in any conduct or practice:

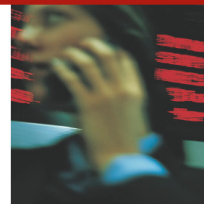
- In connection with the purchase or sale of a security
- Involving making a false filing with the SEC
- Arising from business conducted by an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities

The order must have occurred within five years of the proposed sale of securities.

Final Orders of Certain Regulators

Any covered person is subject to a final order issued by state securities, banking, credit union or insurance regulators, federal banking regulators or the National Credit Union Administration that (A) at the time of the sale bars the person from:

- Association with an entity regulated by such commission, authority, agency or officer
- Engaging in the business of securities, insurance or banking



- Engaging in savings association or credit union activities

Or (B) constitutes an order that is based on a violation of any law or regulation prohibiting fraudulent, manipulative or deceptive conduct entered within 10 years before the sale.

SEC Disciplinary Orders

Any covered person is subject to SEC disciplinary orders that, at the time of the sale:

- Suspend or revoke such person's registration as a broker, dealer, municipal securities dealer or investment adviser
- Place limitations on the activities, functions or operations of such person
- Bar such person from being associated with any entity or from participating in the offering of any penny stock

Suspension or Expulsion of SRO Membership or Association with SRO Member

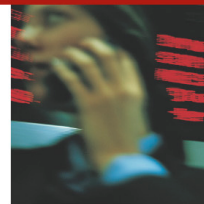
Any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or registered national or affiliated securities association for conduct inconsistent with just and equitable principles of trade. Such act would be disqualifying for the period of suspension or expulsion.

Stop Orders and Orders Suspending Exemptions

Any covered person has filed or was named as an underwriter in any registration statement or Regulation A statement filed with the SEC that, within five years before such sale, was the subject of a refusal order, stop order or order suspending the Regulation A exemption, or is at the time of such sale the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued.

U.S. Postal Service False Representation Orders

Any covered person is subject to a U.S. Postal Service false representation order entered within five years before the sale, or is at the time of such sale subject to a temporary retraining order or preliminary injunction with respect to conduct alleged to constitute a scheme or device for obtaining money or property through the mail by means of false representation.



REASONABLE CARE EXCEPTION

The proposed rules provide an exception from disqualification when the issuer can show it did not know, and in the exercise of reasonable care, could not have known, that a disqualification existed.

WAIVERS

The proposed rules provide for waivers from disqualification under Rule 506 upon showing good cause if the SEC determines that it is not necessary that the exemption be denied.

EVENTS PRE-DATING AFFILIATION

Under the proposed rules, past disqualifying events will be taken into account under the new disqualification rules. Events relating to any affiliated issuer that occurred before the affiliation arose will not be considered disqualifying if the affiliated entity is not in control of the issuer or not under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

SUBMITTING COMMENTS

Comments on the proposed rules should be submitted to the SEC on or before July 14, 2011 by using the **SEC's internet comment form**, using the **Federal Rulemaking Portal**, sending an email³ or mailing written comments.⁴

FOR MORE INFORMATION

For more information, please contact:

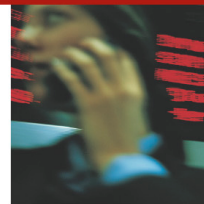
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¹ 15 U.S.C. 77a *et seq.*

² Offerings under Rule 506 are subject to all the terms and conditions of Rules 501 and 502, including limitations on the manner of offering, limitations on resale and, if securities are sold to any non-accredited investors, specified information requirements. Non-accredited investors must also satisfy the investor sophistication requirements of Rule 506(b)(2)(ii). In addition, offerings under Rule 506 must comply with notice of sale requirements of Rule 503.

³ Send emails to rule-comments@sec.gov with “File Number S7-21-11” in the subject line.

⁴ Send written comments in triplicate to Elizabeth M. Murphy, Secretary; Securities and Exchange Commission; 100 F Street, NE; Washington, DC 20549-1090.