



## New C&DIs Regarding 'Bad Actor' Beneficial Ownership (Rule 506)

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The staff of the SEC's Division of Corporation Finance recently published additional "Compliance and Disclosure Interpretations" [[here](#)], starting at 260.28, relating to the bad actor disqualification in Rule 506 under the Securities Act of 1933. The new C&DIs principally relate to the interpretation of "beneficial ownership" and include the following:

- The disqualifying effect of a 20 percent beneficial owner's bad act only applies to the potential sale of securities after the bad actor has acquired 20 percent [CDI 260.28]
- Beneficial ownership is determined pursuant to Rule 13d-3 under the Securities Exchange Act of 1934 (i.e. persons who have or share voting or investment power over the securities or have the right to acquire such power within 60 days) and, therefore, it is necessary to look through entities to their controlling persons in determining beneficial ownership. [CDI 260.29 and 30]
- Just because a group that beneficially owns more than 20 percent of the issuer's securities has a member that is a "bad actor" does not necessarily mean that the issuer is disqualified. More than mere group membership by a bad actor is required to apply the bad actor disqualification. The bad actor must have control over the securities owned by the group, such as voting or dispositive control over the entire group's block of securities, in order for the bad actor's group membership to cause bad actor disqualification. A group may also be disqualified if the group itself is subject to orders, convictions, bars, suspensions or expulsions covered by the rule. [CDI 260.31]
- A court or regulatory authority may not exempt the disclosure of a bad act that occurred before September 23, 2013, pursuant to Rule 506(e) under the Securities Act of 1933. The court or relevant regulatory authority may, however, determine that an

order that was issued prior to September 23, 2013 would not have triggered disqualification if it were issued after such date because the violation was not a "final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct." [CDI 260.32]

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