



California Corporate & Securities Law

SEC Proposes John Wilkes Booth Rules

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On Wednesday, the Securities and Exchange Commission proposed [rules](#) disqualifying felons and other “bad actors” from Rule 506 offerings. In 2007, I submitted this [comment letter](#) arguing, among other things, that the SEC should not impose mandatory disqualification on Regulation D offerings. Now, the SEC no longer has a choice because Section 926 of the Dodd–Frank Act mandates the adoption of disqualification rules for Rule 506 offerings.

Much ado about nothing?

Although on its face it seems reasonable to bar convicted felons and other nefarious people from relying upon Rule 506, the bar actually makes little sense. Rule 506 is a non-exclusive safe harbor exemption (see Preliminary Note 3 to Regulation D). Thus, if the only deficiency is a “bad actor” disqualification, it seems that the offer and sale will be exempt under Section 4(2) of the Securities Act of 1933.

Weakening of investor protection?

To the extent that the SEC believes that the conditions imposed by Rule 506 enhance investor protection, denying issuers the opportunity to rely on Rule 506 will have the unintended consequence of removing incentives to meet those conditions. (As set forth in my comment letter mentioned above, I believe that the conditions to Rule 506 are discriminatory and increase investor risk, but that’s a topic for a different blog.)

Bigger role for states?

Disqualification, however, will have an impact – disqualified offerings will need to focus on Blue Sky requirements. Section 102 of the National Securities Markets Improvement Act of 1996 (NSMIA) preempts state qualification requirements with respect to transactions exempt from registration pursuant to Rule 506. Disqualified offerings will therefore not have the benefit of this preemption and will need to either qualify the offer and sale or identify an appropriate exemption (such as Corporations Code Section 25102(f) which imposes no such bar). Thus, Congress may have unintentionally returned to the states greater regulatory authority over private placements.

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