

Investment Management Alert

July 25, 2013

SEC Permits General Solicitation but Proposes Significant Impediments to its Use

On July 10, 2013, the Securities and Exchange Commission (SEC) adopted amendments to its safe harbor rule for private placements of securities, Rule 506 of Regulation D under the Securities Act of 1933 (the "Securities Act"). One amendment will permit an issuer, including a private fund, to engage in general solicitation and advertising in a private offering under a new paragraph (c) of Rule 506, provided that the securities are sold only to accredited investors and that the issuer takes reasonable steps to verify that all purchasers are accredited investors. Another amendment will prohibit certain "bad actors" from relying on Rule 506 for private placements. Under amended Rule 506, issuers that do not wish to utilize general solicitation and advertising may continue to conduct offerings under existing Rule 506(b), which prohibits general solicitation but permits an issuer to offer and sell securities to up to 35 sophisticated non-accredited investors. In addition, the SEC also amended Rule 144A under the Securities Act to permit a person reselling securities under Rule 144A to engage in general solicitation and advertising provided that the securities are sold only to "qualified institutional buyers."

The final rules will be effective on September 23, 2013. Issuers may begin generally soliciting investors in a Rule 506 offering after that date so long as the securities are only sold to accredited investors and the issuer takes reasonable steps to verify the accredited investor status of investors, as described below.

Contemporaneously with the adoption of the above rules, the SEC proposed additional requirements and conditions on issuers using Rule 506 that would, if adopted, create significant compliance burdens, especially on private funds. For offerings pursuant to Rule 506(c), the proposed rules would, among other things:

- require issuers to "submit" written general solicitation materials to the SEC confidentially for the next two years
- require legends in any written general solicitation materials and additional disclosures for private funds' general solicitation material if the material includes performance data
- solicit additional information on Form D regarding the types of general solicitation used and the methods used to verify accredited investor status
- require issuers to file a Form D not later than 15 calendar days prior to commencing a general solicitation.

In addition, other proposed rules would be applicable to all Rule 506 offerings (whether or not the issuer is engaging in general solicitation). These rules would, among other things:

- require issuers to file an amendment to Form D within 30 calendar days after terminating a Rule 506 offering, which would include complete information regarding the offering (including the amount of capital raised)
- disqualify issuers from using Rule 506 for future offerings for one year if they failed to file a Form D within the past five years
- extend the application of Rule 156 under the Securities Act, which prohibits misleading statements in sales literature of registered investment companies, to private funds
- solicit additional information to be provided on a revised Form D regarding the use of proceeds, the offered securities, the breakdown of the type of investors and the amounts raised from each type of investor.

New Rule 506(c) Offerings

New Rule 506(c) permits an issuer to generally solicit or advertise to investors so long as (i) it complies with all other applicable conditions of Regulation D, such as limitations on resale, (ii) all purchasers of securities sold in the Rule 506(c) offering are accredited investors (as defined in Rule 501 of Regulation D), either because they are within one of the enumerated categories of persons that qualify as an accredited investor or the issuer reasonably believes that they are, and (iii) the issuer takes reasonable steps to verify that the purchasers are accredited investors.¹

Amount and Types of Information Required to Be Collected

Whether the procedures used to verify accredited investor status are reasonable will be determined by an objective analysis based on the facts and circumstances surrounding the offering and the issuer, including:

- the nature of the purchaser and type of accredited investor that the purchaser claims to be
- the amount and type of information that the issuer has regarding the purchaser
- the nature of the offering, including the manner in which the purchaser was solicited, and the terms of the offering.

If the above factors indicate a low risk of non-accredited investors having invested in the offering, reduced efforts to verify may be objectively reasonable. For example, if an issuer advertises in a newspaper of general circulation, it will be required to take more steps than if it contacted names in a prescreened

¹ Note that the fact that all purchasers are, in fact, accredited investors does not satisfy the conditions of the rule if the issuer does not, in fact, take reasonable steps to verify that the investors are accredited.

database. The SEC also stated that, in an offering with a minimum investment amount that is sufficiently high so that only accredited investors would reasonably be expected to meet it, it may be reasonable, absent facts to indicate that the investor was not accredited, to “take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to confirm that the purchaser’s cash investment is not being financed by a third party.”

The information requested and methods used to verify the accredited investor status of the potential purchaser also must be reasonable, but the final rule provides four methodologies that will be deemed to satisfy the reasonable procedures requirement for potential natural person purchasers:

- For natural persons who claim to be accredited investors because they have an income in excess of \$200,000 (or \$300,000 with his/her spouse) in each of the two most recent years and a reasonable expectation of reaching the same income level in the current year, the rule specifies that it would be reasonable to rely on Internal Revenue Service forms that report the potential purchaser’s income for the two most recent years (such as a W-2, Form 1099, Schedule K-1 or Form 1040) and a representation that the investor has a reasonable expectation that he or she will have the necessary income level in the current year.
- For natural persons claiming to be accredited investors due to having individual or joint net worth in excess of \$1 million,² it would be reasonable to examine the following so long as they are dated within three months of the date of determination: (i) for assets — bank statements, brokerage statements, certificates of deposit, tax assessments and third-party appraisals and (ii) for liabilities — a consumer report from one of the nationwide consumer reporting agencies. In addition, the potential purchaser claiming to have in excess of \$1 million should also provide a representation that all liabilities relevant to the net worth determination have been disclosed.
- The SEC also permits issuers to rely on a written confirmation from a registered broker-dealer, an SEC registered investment adviser, a licensed attorney in good standing or a certified public accountant that he or she has taken reasonable steps within the last three months to verify that the potential purchaser is an accredited investor and has determined that the potential purchaser is, in fact, accredited.
- Finally, for a natural person who invested in an issuer’s Rule 506(b) offering prior to September 23, 2013, and remains an investor of the issuer, it would be reasonable to obtain a certification from such person at the time of sale that he or she still qualifies as an accredited investor.

While the SEC clarified that the above methods for verifying accredited investor status for natural persons are not meant to be an exclusive list, many commentators expect that most issuers relying on Rule 506(c) will use the verification methods in the above list. The SEC did not provide guidance for entities, but

² The \$1 million does not include the value of the primary residence, but debt secured by the primary residence is also not included as a liability, except to the extent that it exceeds the value of the residence by which it is secured or it was increased in the 60 days prior to the investment.

financial statements will likely be used to verify the requisite \$5 million in total assets threshold, and database searches may be used for those entities whose accredited investor status depends on their regulatory status.

Form D Filing

The SEC amended Form D to add a separate box that an issuer must check if it is relying on new Rule 506(c). Issuers that have previously relied on Rule 506 but are opting to generally solicit must transition to Rule 506(c), because they may not rely on both parts of Rule 506 for the same offering.

Transition Guidance

Issuers may choose to continue an offering that commenced prior to the effective date of Rule 506(c) in accordance with new Rule 506(c) or under the previous version of Rule 506 in Rule 506(b). Issuers that choose to continue an offering under Rule 506(c) will not negatively affect the exemption for the portion of the offering prior to the effectiveness of the rule amendments due to its general solicitation in the 506(c) offering. The SEC did not, however, provide guidance permitting an offer to be transitioned from prior Rule 506 to a Rule 506(c) offering if non-accredited investors had participated in the prior portion of the offering, nor did it provide guidance on the transition of an offering that commences after the date of the effectiveness of the rules from 506(c) to 506(b).

Offerings Under Section 4(a)(2) of the Securities Act

Although Rule 506 was adopted under Section 4(a)(2) of the Securities Act,³ the SEC has stated that offerings conducted without the benefit of the safe harbor rule will remain subject to the prohibition on general solicitation. Therefore, if an issuer is disqualified from relying on Rule 506 due to the bad-actor provisions or the proposed disqualifications below, it would not be permitted to engage in general solicitation, and it may be required to cease offering for a period of time in order to establish a separate Section 4(a)(2)⁴ offering.

Special Considerations for Private Funds

The SEC has specifically stated that Congress had intended for private funds to be permitted to use new Rule 506(c). The Commodity Futures Trading Commission (CFTC), however, has not yet proposed changes to its reduced compliance regime under Regulation 4.7⁵ or its exemptions for commodity pool

³ Section 4(a)(2) was re-designated from Section 4(2) of the Securities Act of 1933 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

⁴ Note that offerings under Section 4(a)(2) (as opposed to those under a rule promulgated under Section 4(a)(2)) are not exempt from “blue sky” laws. There is also some uncertainty regarding so-called “Section 4(1½)” transfers because of the SEC’s statements regarding the applicability of Section 4(a)(2) when the issuer engages in general solicitation.

⁵ CFTC Regulation 4.7 permits commodity pool operators who “offer or sell” interests in their commodity pools only to persons who satisfy the criteria to be “qualified eligible persons” in an offering that qualifies for the Section 4(a)(2) exemption from registration or Regulation S to have reduced disclosure, reporting and recordkeeping requirements.

operators under Regulation 4.13(a)(3).⁶ Until the CFTC or its staff provides guidance, the ability to rely on these exemptions and to conduct general solicitation will be uncertain.

In addition, as discussed below, registered investment advisers to funds that conduct general solicitation will likely be subject to additional scrutiny, and the filing of a Form D to claim the Rule 506(c) exemption may increase the risk of inspection by the SEC's Office of Compliance Inspections and Examinations. Private fund investment advisers using Rule 506(c) must amend their policies and possibly their subscription documents to reflect their planned practices to verify accredited investor status and should maintain books and records to demonstrate their compliance with the new requirements for each investor and/or offering to prepare for an examination. In particular, they may wish to revise subscription materials to obtain a representation that the investment has not been financed and to request further assurances that necessary information, such as tax returns, financial statements or other documentation, will be provided upon request.

Rule 144A General Solicitation

As required by the JOBS Act, the SEC amended Rule 144A to permit security holders to offer securities more generally, including through general solicitation, so long as the securities are sold only to persons that the seller and any person acting on its behalf reasonably believe are "qualified institutional buyers."

Bad Actor Disqualifications

As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, new Rule 506(d) will prohibit an issuer from relying on Rule 506 if the issuer or certain of its affiliates have been convicted of or are subject to court or administrative sanctions for having violated specified laws that occur after September 23, 2013.

Under new Rule 506(d), an issuer may be disqualified for its "bad acts," as well as the bad acts of its affiliates, its management and certain of its service providers. The final rules reference the following persons that could potentially disqualify the issuer due to their bad acts (each of the following, other than the relevant issuer, an "issuer affiliate"):

- the issuer
- any predecessor of the issuer
- any affiliated issuer
- any director
- any executive officer

⁶ CFTC Regulation 4.13(a)(3) requires interests in the pool for which a commodity pool operator exemption is claimed to be "offered and sold without marketing to the public in the United States."

- any other officer participating in the offering⁷
- a general partner or managing member of the issuer
- any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities⁸
- any promoter connected with the issuer at the time of the sale
- any investment manager of an issuer that is a pooled investment fund⁹
- any person that is paid remuneration for solicitation of purchasers in connection with the sale of securities in the offering (a "compensated solicitor")
- any general partner, managing member, director, executive officer or other officer participating in the offering of the investment manager or compensated solicitor.

The rule will be triggered by the issuer or any issuer affiliate having committed one of the bad acts specified in the rule. In general, an issuer would be disqualified if it or an issuer affiliate was convicted of a felony or misdemeanor in connection with securities purchases or sales, making false filings or in the conduct of operating as an investment adviser or compensated solicitor, or was subject to a court order enjoining the above violations. In addition, the rule will also be triggered by final orders of a state securities authority, banking authority, insurance commissioner, national securities exchange or registered national securities association, the CFTC or the SEC that bars, suspends or limits the ability of the issuer or any issuer affiliate from conducting business. Finally, the rule will disqualify persons who have been subject to a cease and desist order relating to Section 5 of the Securities Act or any scienter-based anti-fraud provision of the federal securities laws. For a complete list of "bad acts," see [Appendix A](#).

In general, the bad actor provision will prohibit an issuer's reliance on Rule 506 by issuers or issuer affiliates within the past five or 10 years for convictions or court or SEC orders and current bans for many other regulatory authorities. The prohibition will not apply to convictions, orders, judgments or bars that

⁷ Participation in the offering "would have to be more than transitory or incidental involvement and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents, and communication with the issuer, prospective investors or other offering participants." See SEC Release 33-9414 (July 10, 2013) (the "Bad Actor Adopting Release"), text at notes 47 to 48.

⁸ The SEC stated that it "intend[s] that the term should be applied based on whether securityholders have or share the ability, either currently or on a contingent basis, to control or significantly influence the management and policies of the issuer through the exercise of a voting right. For example, we would consider that securities that confer to securityholders the right to elect or remove the directors or equivalent controlling persons of the issuer, or to approve significant transactions such as acquisitions, dispositions or financings, would be considered voting securities for purposes of the rule. Conversely, securities that confer voting rights limited solely to approval of changes to the rights and preferences of the class would not be considered voting securities for purposes of the rule." See the Bad Actor Adopting Release, text at note 62. Any beneficial ownership would be calculated on a consolidated basis, based on the total voting power, as opposed to a class-by-class basis.

⁹ The term "investment manager" is meant to be broader than the term "investment adviser" as defined in the Investment Advisers Act of 1940. The term "pooled investment fund" includes not only private funds, but also commodity pools and other entities formed for the purpose of collective investment.

occurred before September 23, 2013. Issuers will, however, be required to furnish a description of any bad act prior to September 23, 2013, to each purchaser prior to each sale.

An issuer will not be prohibited from relying on Rule 506 due to a bad act or the failure to disclose a bad act if it did not know and, in the exercise of reasonable care, could not have known of that bad act. The rule specifies that reasonable factual inquiry must have been made to establish this defense.

The SEC will also have the ability to waive the disqualification under the rule if the issuer shows good cause. In addition, the regulatory authority or court that entered the relevant judgment or order may prevent the disqualification if it advises in writing before the date of a sale under Rule 506 that disqualification of the bad actor provision should not arise as a consequence of the judgment or order.

Consequences for Issuers

Issuers may need to update their subscription documents or questionnaires for their directors, officers and significant securityholders to collect information regarding bad acts that may trigger the effects of the bad actor provisions of the rule. Investment managers will need to update their policies to address the new provision and retain records to demonstrate that they took reasonable steps and made reasonable inquiries of issuer affiliates. Finally, issuers that retain compensated solicitors should consider updating their agreements to obtain representations that such solicitors have not committed any of the enumerated bad acts.

Proposed Changes for All Issuers Relying on Regulation D

To address investor protection concerns relating to lifting the ban on general solicitation and advertising and to enhance the SEC's understanding of market practices in Rule 506 offerings, the SEC proposed a number of investor protection and information-gathering measures, which, if enacted, may dissuade some issuers from using a general solicitation in Rule 506 offerings.

Submission of General Solicitation Materials

The SEC proposed new Rule 510T that would require issuers relying on Rule 506(c) to "submit" written general solicitation materials to the SEC. As proposed, the general solicitation information would be provided to the SEC via a private intake page no later than the date of first use and would not be "filed" with or "furnished" to the SEC. The requirement to submit the information would, if adopted as proposed, apply for only two years after effectiveness. Compliance with Rule 510T's filing requirement would not be a condition to Rule 506(c), but the SEC could seek an injunction for failure to file general solicitation materials, which would prohibit the issuer's ability to rely on Regulation D in future offerings.

Requirement to Include Legends in General Solicitation Materials for All Issuers

Proposed Rule 509 would require issuers to include the following prominent legends in all written general solicitation materials used in a Rule 506(c) offering:

- The securities may be sold only to "accredited investors," which, for natural persons, are investors who meet certain minimum annual income or net worth thresholds.

- The securities are being offered in reliance on an exemption from the registration requirements of the Securities Act and are not required to comply with specific disclosure requirements that apply to registration under the Securities Act.
- The SEC has not passed upon the merits of, or given its approval to, the securities, the terms of the offering, or the accuracy or completeness of any offering materials.
- The securities are subject to legal restrictions on transfer and resale and investors should not assume they will be able to resell their securities.
- Investing in securities involves risk, and investors should be able to bear the loss of their investment.

As with the temporary requirement to submit general solicitation materials, the requirement to include legends on those materials would not be a condition to the use of Rule 506. An issuer that is subject to an order, judgment or court decree enjoining it for failing to include the legends would, however, be prohibited from relying on Rule 506 in future offerings.

Additional Information Requested in Forms D

The SEC proposed to amend Form D to require the issuer to provide more specific information in Rule 506 offerings. The amended Form D would require information on, among other things, (i) the issuer's publicly accessible website address, (ii) the use of proceeds (for issuers other than pooled investment funds), (iii) the manner in which investors qualified as accredited investors, (iv) whether general solicitation materials were filed with the Financial Industry Regulatory Authority, Inc., (v) the name and file number of the investment adviser (for pooled investment vehicle issuers), (vi) the types of general solicitation used (for 506(c) offerings), (vii) the methods of verification of accredited investor status used (for 506(c) offerings) and (viii) the amounts raised from each type of investor.

Additional Forms D

Under the existing rules, issuers selling securities in a Rule 506 offering are required to file a notice of sale on Form D with the SEC no later than 15 calendar days after the first sale of securities in the offering. The SEC proposed to amend this filing requirement to require issuers relying on Rule 506(c) to file an initial Form D not later than 15 calendar days prior to conducting any general solicitation activities. Issuers may omit certain information from this "advance Form D" but must then amend the advance Form D to provide the remaining information within 15 calendar days after the first sale occurs. In addition, the SEC has proposed that issuers be required to file a final amendment to Form D within 30 calendar days after the termination or abandonment of a Rule 506 offering, which form would include final information regarding the offering (including the amount of capital actually raised in the offering).

One-Year Disqualification for Failure to File a Form D

Under current rules, although an issuer is required to file a Form D, the failure to file does not disqualify the issuer from relying on Regulation D, nor does it limit the issuer's ability to use Regulation D in future offerings unless a court enjoins an issuer for violating the filing requirements. The SEC has proposed to

amend the filing requirements to automatically disqualify an issuer from using Rule 506 for any new offering for one year if the issuer or any of its affiliates or predecessors failed to file a Form D in a Rule 506 offering within the five-year period preceding the new offering. The one-year period would commence following the filing of all required Form D filings for the previous offering. This disqualification would be subject to a once-per-offering cure period of 30 calendar days. The disqualification would only result from Form Ds that are not filed starting after the rules are effective.

Given the number of proposed changes to Form D, issuers would need to closely monitor their Form D filing practices if this amendment is adopted. The proposed disqualification provision is broadly drafted and could, as the SEC alludes to in the proposing release, result in a portfolio company of a private fund being prohibited from using Rule 506 because of the failure of its affiliated fund to file a Form D.

Additional Proposed Changes Applicable to Private Funds and Their Advisers

A number of the proposed changes and the SEC's supervisory efforts are specifically targeted at private funds, including additional legending and marketing requirements. The SEC is also considering, but has not proposed, mandated standardized methodologies of calculating past performance for private funds.

Requirement to Include Additional Legends in General Solicitation Materials for Private Funds

In addition to the legends that would be required for any issuer conducting a general solicitation, a private fund issuer would be required to include an additional legend and make additional disclosures in their written general solicitation materials. First, private funds would be required to include a legend that the securities offered are not subject to the protections of the Investment Company Act of 1940. Also, any private fund issuer that includes performance data in any written general solicitation materials would be required to disclose the following:

- The performance data represents past performance, past performance does not guarantee future results and current performance may be lower or higher than the performance data presented.
- The private fund is not required by law to follow any standard methodology when calculating and representing performance data, and the performance of the private fund as reported may not be directly comparable to the performance of other funds.
- The presentation does not reflect the deduction of fees and expenses, and, if such fees and expenses had been deducted, performance may be lower than presented (must be included if the performance data does not reflect the deduction of fees and expenses).¹⁰

In addition, all performance data disclosed must be as of the most recent practicable date and must disclose the period for which performance is presented, and the private fund would be required to

¹⁰ Neither the release nor the rule attempt to reconcile the limitations regarding presenting performance under the Investment Advisers Act of 1940 and the related no-action letters applicable to registered investment advisers and the language in the required legends and Rule 156.

disclose a telephone number or publicly accessible website where an investor may obtain current performance data.

Proposed Extension of Rule 156 to Private Funds

Rule 156 under the Securities Act provides guidance on the types of information in investment company sales literature that could be misleading for the purposes of the federal securities laws. The SEC proposes to extend the application of Rule 156 to private funds. The definition of sales literature under the proposed rule would be broad and would include any communication used by any person “to offer or sell or induce the sale of securities of any investment company or private fund,” including communications between issuers, underwriters and dealers that can reasonably be expected to be used in marketing the investment company or private fund.

Rule 156 provides an interpretation of what constitutes a misleading statement that could give rise to liability under the Securities Exchange Act of 1934, including Section 10(b) and Rule 10b-5 thereunder, and under the Investment Company Act of 1940. As under Rule 10b-5, sales literature is materially misleading if it (i) contains an untrue statement of a material fact or (ii) omits to state a material fact necessary in order to make a statement made, in the light of the circumstances of its use, not misleading. Whether a statement may be materially misleading is a facts and circumstances evaluation depending on the context of the statement. Rule 156, however, provides specific examples of statements that may, depending on the surrounding context, be misleading, such as:

- exaggerated or unsubstantiated claims about management skill or techniques or the characteristics of the fund
- absence of explanations, qualifications, limitations, or other statements necessary or appropriate to make a statement not misleading
- portrayals of past income, gain or growth of assets that convey an impression of the net investment results achieved by an actual or hypothetical investment that would not be justified under the circumstances, including portrayals that omit explanations, qualifications, limitations or other statements necessary or appropriate to make the portrayals not misleading¹¹
- misleading express or implied representations regarding future performance, including:
 - representations, as to security of capital, possible future gains or income or expenses associated with an investment
 - representations implying that future gain or income may be inferred from or predicted based on past investment performance or

¹¹ For example, the SEC has brought an enforcement action against a fund that failed to disclose the effect of unusually high initial public offering proceeds that were unlikely to recur and that emphasized past-quarter returns when the returns for the current ongoing quarter were significantly worse.

- portrayals of past performance made in a manner that would imply that gains or income realized in the past would be repeated in the future
- misleading statements about possible benefits connected with, or resulting from, services to be provided or methods of operation that do not give equal prominence to discussion of any risks or limitations associated therewith
- unwarranted or incompletely explained comparisons to other investment vehicles or to indexes.

The rule also states that information in sales literature may be misleading depending on general economic or financial conditions or circumstances in which a statement is made and other statements that have been made in connection with the offer or sale of the securities in question.

It seems likely that the SEC will extend Rule 156 to private funds, as the staff stated that advisers to private funds should begin preparing for the application of Rule 156 as soon as possible. Many of the above restrictions are similar or less restrictive than the guidance that many registered investment advisers are already following due to the advertising rule under the Investment Advisers Act of 1940 and its related no-action letters.

Work Plan and Impact on Inspection

The SEC stated in the proposing release that the SEC's staff will execute a "comprehensive work plan upon the effectiveness of Rule 506(c) to review and analyze the use of Rule 506(c)." The work plan will involve a coordinated effort with, among others, the Office of Compliance Inspections and Examinations and the Division of Enforcement. The group of staff participating in the plan will examine the information submitted and "incorporate an evaluation of practices in Rule 506(c) offerings in the staff's examinations of registered. . . investment advisers." Given the risk-based approach that the staff currently takes in investment adviser examinations, it is likely that the decision to opt into general solicitation by checking the Rule 506(c) box may impact the likelihood that an investment adviser to a private fund will be examined by the SEC staff.

Conclusion

Issuers that are planning to use general solicitation in a Rule 506 offering need to address the requirements of the Rule 506(c) discussed above, including the methods they will use to verify whether the investors are accredited. Issuers will also need to address the bad actor rules by making relevant inquiries to confirm that they will be able to use Rule 506 and whether disclosure will be required prior to the sale of securities.

Although many issuers may welcome the use of general solicitation in Rule 506 and Rule 144A offerings, the additional compliance burdens that the SEC has proposed, including presubmission of general solicitation materials, legending requirements and advanced filing of Form D, may, if adopted, discourage issuers from taking advantage of general solicitation. Private fund advisers in particular may be disappointed by the proposed changes. Many private fund advisers were expecting to be able to remove

the password protection from the information on their websites or to more freely discuss the funds that they advise. Unfortunately, the SEC designed investor protection measures with the assumption that private funds would generally advertise instead of taking such incremental steps toward general solicitation and general advertisement.

Appendix A

Bad Actor Disqualification Events

- I. Has been convicted, within 10 years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:
 - A. in connection with the purchase or sale of any security
 - B. involving the making of any false filing with the Commission or
 - C. arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;
- II. Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:
 - A. in connection with the purchase or sale of any security
 - B. involving the making of any false filing with the Commission or
 - C. arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;
- III. Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:
 - A. at the time of such sale, bars the person from:
 1. association with an entity regulated by such commission, authority, agency, or officer
 2. engaging in the business of securities, insurance or banking or
 3. engaging in savings association or credit union activities or
 - B. constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct entered within 10 years before such sale;
- IV. Is subject to an order of the Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 or section 203(e) or (f) of the Investment Advisers Act of 1940 that, at the time of such sale:
 - A. suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser

- B. places limitations on the activities, functions or operations of such person or
 - C. bars such person from being associated with any entity or from participating in the offering of any penny stock;
- V. Is subject to any order of the Commission entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of:
- A. any scienter-based anti-fraud provision of the federal securities laws, including without limitation, section 17(a)(1) of the Securities Act, section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, section 15(c)(1) of the Securities Exchange Act of 1934 and section 206(1) of the Investment Advisers Act of 1940, or any other rule or regulation thereunder or
 - B. section 5 of the Securities Act.
- VI. Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;
- VII. Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the Commission 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; or
- VIII. Is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

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