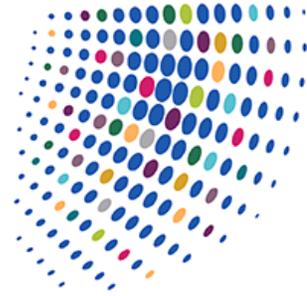


Alerts & Publications



SEC Offers Guidance on Beneficial Ownership "Look Through"

January 13, 2014

"Look Through" Requirement for Private Funds Complying with "Bad Actor" Rule

On January 3, 2014, the Staff of the SEC's Division of Corporation Finance updated its Securities Act Rules Compliance and Disclosure Interpretations ("C&DIs") with new questions and answers interpreting the "bad actor" disqualification provisions under Rule 506(d) of Regulation D (the "Bad Actor Rule"). The updates comprise questions 260.28 through 260.32 of the C&DIs, which are available [here](#).

Beneficial Ownership Mirrors Exchange Act Interpretation

The C&DIs update confirms that beneficial ownership under Rule 506(d) is interpreted in the same way as under Rule 13d-3 of the Securities Exchange Act of 1934. A "beneficial owner" under Rule 506(d) is: any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, under Exchange Act Rule 13d-3 has or shares, or is deemed to have or share: (1) voting power, which includes the power to vote, or to direct the voting of, such security; and/or (2) investment power, which includes the power to dispose, or to direct the disposition of, such security.

Beneficial Ownership "Look Through"

In addressing whether 506(d) beneficial ownership requires a "look through" to controlling persons of a given entity, the Staff confirmed that beneficial ownership includes both direct and indirect interests, as determined under Exchange Act Rule 13d-3. Similarly, the Staff explained that beneficial ownership by groups (such as voting agreements) and individual group members is analyzed according to Exchange Act Rules 13d-3 and 13d-5(b). If the group is deemed to be a 20% beneficial owner, or if a group member becomes a 20% beneficial owner because shares of other members are added to its original beneficial ownership, disqualification or disclosure obligations would arise from triggering events against the group itself or by that individual group member, respectively. The Staff further clarified that those group members who have or share the power to vote or direct the vote of shares beneficially owned by other parties to a voting agreement are deemed beneficial owners of the group's shares. Absent such power, group members would not beneficially own such shares solely as a result of being part of the group.

"Covered Persons" During the Course of an Offering

The C&DIs update confirms that the Rule 506(d) disqualification attaches at the time of sale of each security. Accordingly, shareholders who become 20% beneficial owners upon completion of a sale are not "covered persons" at the time of sale, but 20% beneficial owners are "covered persons" with respect to any sales in the offering that were made while the person was a 20% beneficial owner.

Regulatory Implications and Issues to Consider

Investment funds and other entities seeking to rely on the Rule 506 exemption from registration should consider the impact of this guidance on initial and ongoing compliance procedures. The guidance confirms that issuers relying on Rule 506 should understand the ownership structure of potential purchasers and properly evaluate any “bad actor” issues arising from their direct or indirect owners. In addition, the guidance confirms that continuous offerings under Rule 506 have the potential to create compliance issues at their outset — initial investors who may not reach the 20% ownership threshold at the conclusion of the offering could own greater than 20% of the offered securities during early stages of the offering process and thereby trigger “bad actor” disqualification. Accordingly, compliance procedures should be designed to account for potential “bad actor” concerns that could arise from sales that occur throughout the offering process.

O'Melveny & Myers LLP is assisting fund clients with analysis of and compliance with the Bad Actor Rule. For questions or additional information regarding your obligations under the Bad Actor Rule, please contact Heather Traeger at (202) 383-5232 or James M. Harrigan at (202) 383 5226.

This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. Heather Traeger, an O'Melveny partner licensed to practice law in the District of Columbia and Texas, and James Harrigan, an O'Melveny associate licensed to practice law in the District of Columbia and Maryland, contributed to the content of this newsletter. The views expressed in this newsletter are the views of the authors except as otherwise noted.

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