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## **SEC Further Limits Use of Finders Fees**

The Securities and Exchange Commission's (SEC) position on the payment of finder's fees to non-registered broker-dealers has been further clarified in a recent request for a No-Action Letter which was denied by the SEC. That clarification bodes poorly for those who are looking for a more expansive interpretation of the finder exemption from broker-dealer registration. Historically, in determining whether a person should be registered as a broker-dealer, the SEC has primarily considered five factors in evaluating the conduct of the unregistered participant: (i) whether the person participates in the negotiations surrounding the transaction; (ii) whether the person makes recommendations or gives advice concerning the transaction; (iii) whether the person receives transaction based compensation in connection with the transaction; (iv) whether the person has engaged in previous securities transactions; and, (v) whether the person takes physical possession of the securities or monies to be transferred between the parties introduced. The SEC has stated numerous times that the presence of any one of the factors would not necessarily cause the SEC to conclude that the person is acting as a broker in the transaction. The SEC denial to the request for No-Action Letter appears to change that presumption.

### **Exemption to Broker-Dealer Registration Weakened**

The law firm of Bromberg, Mackey & Wall, P.L.C. ("BMW") requested a [No-Action Letter](#) from the SEC regarding its proposed activities on behalf of Electronic Magnetic Power Solutions, Inc, a Tennessee corporation ("EMPS"). As a part of its engagement with EMPS, BMW asserted that it would only assist EMPS in the acquisition of funding for financing to fund the operations and development of EMPS, and as such, would only introduce to EMPS individuals and entities who "may have an interest" in providing financing to EMPS through investments in equity or debt instruments. It was then anticipated that BMW would be compensated upon the closing of the financing based upon a percentage of the amounts raised. BMW represented in the request that its role would be limited to the introduction of EMPS to a limited number of its contacts who may have an interest in providing funds for financing the operations and development of EMPS, and as such, BMW would not: (1) engage in any negotiations whatsoever on behalf of EMPS and any such contact; (2) provide any such contact with any information about EMPS which may be used as the basis for any negotiations for funding to be provided to EMPS; (3) have any responsibility for, nor make any recommendations concerning the terms, conditions, or provisions of any agreement between EMPS and any such contact providing funding for EMPS; and (4) provide any assistance to any such contact or EMPS with respect to any transactions involving the financing of funds for EMPS.

In the SEC's denial of the request for a No-Action Letter, the SEC stated that: "A person's receipt of transaction-based compensation in connection with these activities is a hallmark of broker-dealer activity". Accordingly, the SEC asserted that it believed that the introduction to EMPS of only those persons with a potential interest in investing in EMPS's securities implies that BMW anticipates both "pre-screening" potential investors to determine their eligibility to purchase the securities, and "pre-selling" EMPS's securities to gauge the investors' interest. Moreover, the transaction compensation would then give BMW a "salesman's stake" in the proposed transactions and would create heightened incentive for BMW to engage in sales efforts. As a result, the SEC believed that the proposed activities of BMW would require broker-dealer registration, and denied the request for a No-Action Letter.

### **Impact on Investment Banking Activities**

In addition to the impact on the payment of finder fees, especially in a "introduce and step away scenario", the SEC cited a 2003 SEC Release related to auditor independence whereby it asserted that "a person may 'effect transactions", among other ways by helping an issuer to identify potential purchasers of securities". Such activity has been viewed historically as more of an advisory activity, but it appears that when that activity is tied to transaction based compensation, the SEC now believes those activities will in all likelihood require registration as a broker-dealer.

### **Summary**

While the activities of finders and subsequent payments to finders for the referral of potential clients have been the subject of numerous decisions and interpretations by the SEC, it appears that the SEC is moving away from its historical reliance on the balancing of the five factors as to whether it will require broker-dealer registration. The denial of the BMW request for No-Action Letter clearly reflects that the current position of the SEC, which appears to have transitioned to point where the payment of transaction based compensation may be the primary factor to be considered with respect to the requirement to register as a broker-dealer. To the extent that there is a presumption established that if transaction based compensation is paid, all participants will need to be registered as a broker-dealer, or be subject to a specific exemption from registration, the issue of whether finders fees can be paid may become a moot issue. That will clearly have a significant impact on investment banking and private placement transactions.

We hope that this information has been helpful to you. Should you have any additional questions or concerns, please feel free to contact Daniel E. LeGaye or Michael Schaps by [e-mail](#) or phone, at 281-367-2454, or consult with your legal counsel or third party consultant.

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