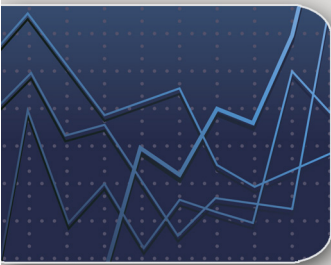




September 2012



### A Polsinelli Shughart Update

## A Money Finder's Commission by Any Other Name Is Still a Commission

Although the use of money finders is prevalent, particularly among smaller businesses seeking capital, many finder arrangements may involve the type of activities and compensation structures that would cause the finder to come within the definition of a broker-dealer. While some finders who cross the broker-dealer line do so without any appreciation of the regulatory risks involved, most recognize that they are probably operating illegally but take comfort in the apparent infrequency of enforcement of broker-dealer laws by regulators. Other finders seek to re-characterize the services they provide as not involving the sale of securities. However, a recent SEC enforcement

action serves as a stark reminder that securities regulators, when they do act, will look only to the substance, and not the form, of a finder arrangement in determining whether registration as a broker-dealer was required. This E-Alert discusses the SEC enforcement action, its regulatory background, and the consequences for finders and the businesses who engage them for performing broker-dealer activities without being registered.

### Regulatory Background

Under the Securities Exchange Act of 1934 (the "Exchange Act"), it is unlawful for a broker or dealer to effect any securities transaction unless

they are registered as such. A broker is defined under the Exchange Act as any person engaged in the business of effecting transactions in securities for the account of others. The SEC has broadly interpreted this phrase to include activities such as: recommending the purchase of securities, negotiating terms of a securities offering, attending meetings where the merits of a proposed investment are discussed, providing valuations, and handling the funds of others. However, the SEC's broad interpretation of the phrase generally does not include an individual (a "finder") who merely introduces a potential investor to a company seeking capital, even though compensation is paid to the finder for the introduction. As a practical matter, this finder exemption is very narrow.

In the SEC's view, the compensation of a finder may be the most critical factor in the determination of whether a finder should be registered. The SEC has taken the primary position that fees based in proportion to the amount of a sale is a strong indication that suggests a finder would be required to register. Also, if a finder's fee is contingent on the consummation of the transaction, the SEC has generally taken the position that the finder is not exempt from registering as a broker.

### SEC Enforcement Matter

On July 30, 2012, the United States Securities and Exchange Commission issued an order entered by consent in an administrative cease-and-desist proceeding against Stephen Mazuchowski a/k/a Steve Mazur ("Mazur") relating to Mazur's actions as an unregistered broker-dealer in connection with two separate private offerings.

According to the facts set forth in the SEC's order, Mazur learned in mid-2007 that a China company was seeking to raise capital in a private offering. Armed with this information, Mazur began engaging in conversations with various individuals at the investor relations firm working with the company, the registered broker-dealer

acting as the official placement agent for the company, and a consulting firm assisting the company to determine how he could earn a commission for bringing investors to the company.

Subsequently, Mazur and the consulting firm, with the knowledge of the president of the placement agent firm, reached an agreement pursuant to which Mazur would receive transaction-based compensation of 5% based on the dollar amount of investments Mazur introduced to the company. Mazur solicited investors for the company by distributing confidential offering documents, distributing a model that he prepared on the company, reviewing and commenting on the terms of the transaction, including the subscription documents, and facilitating the closing of the transaction, including having documents signed and transmitting such documents to the placement agent firm.

In August 2007, the company announced the completion of the transaction of \$8,725,130 to 20 investors, of which Mazur introduced \$4,250,000.

In an apparent attempt to conceal the true nature of the services he provided, Mazur contacted the consulting firm following the closing of the transaction and executed a backdated consulting agreement between the consulting firm and Mazur's employer, an institutional broker-dealer that was not managing or selling the transaction on behalf of the company. Under the terms of this backdated agreement, Mazur's employer was to have provided the consulting firm with



“strategic consulting services” including assisting in issuing press releases, participating in conference calls, communicating with investors, and providing other consulting assistance. Although not authorized to do so, Mazur signed the agreement in his capacity as a representative of his employer. Subsequently, an edited agreement was entered into between Mazur’s firm and the consulting firm that did not contain an enumerated list of services to be provided by Mazur’s employer, but instead generically referred to “consulting services” and further stated that the services had already been provided and that the consulting firm was satisfied with the services.

Notwithstanding the references to consulting services in the written agreements, Mazur received transaction-based compensation for his selling efforts, not for any consulting services.

Similar to Mazur’s actions with respect to the first Chinese company, Mazur was approached in early 2008 by a placement agent to privately place securities on behalf of a second Chinese company. Without the knowledge of his employer, Mazur entered into an oral agreement with the second company’s placement agent to solicit investors in exchanges for transaction-based compensation. Mazur then solicited potential investors in the weeks leading up to the closing of the offering by emailing term sheets, presentations, and other communications concerning the private offering.

The form of the agreement with the placement agent firm for this company was substantially similar to the written agreements concerning the first company’s private offering. Under this agreement, Mazur’s employer was to provide “general services” for a fixed dollar amount (which non-coincidentally equaled a 4% commission on the investments Mazur introduced to the second company). The written agreement was presented to Mazur’s broker-dealer after the private offering closed and after Mazur had already solicited investors on behalf of the second company. Mazur’s broker-dealer approved the written

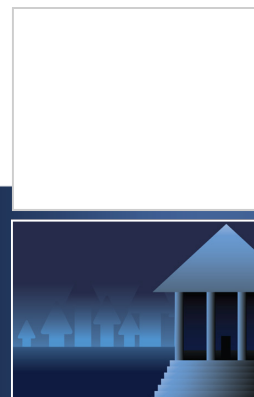
agreement under the pretext that consulting services were provided by Mazur to another broker-dealer.

In its order, the SEC found Mazur’s actions with respect to the two companies exceeded those of a “money finder” and instead were actions of a broker-dealer in violation of the Exchange Act.

In determining sanctions, it appears the SEC considered Mazur’s unregistered activities as well as his efforts to cover his tracks. The SEC assessed several penalties against Mazur, including the following:

- Requiring Mazur to disgorge the commission he received, plus the payment of prejudgment interest on such amount;
- Requiring Mazur to pay civil penalties; and
- Ordering Mazur to cease and desist from violating the Exchange Act.

Because he was “selling away” from his broker-dealer, Mazur was also barred from associating with any broker, dealer, investment adviser, municipal securities dealer, transfer agent, or nationally recognized statistical rating organization, prohibited from serving or acting as an employee, officer, or director of an advisory board, investment advisor, a principal underwriter of a registered investment company, or affiliated person of such investment advisor or principal underwriter, and barred from participating in any penny stock offering.



This is just one example of the consequences faced by a finder who functions as an unregistered broker-dealer. In addition to SEC and state regulatory actions, finders who violate federal and state securities laws by failing to register as broker-dealers subject themselves to civil liability to disgruntled investors. Moreover, because contracts made in violation of federal and state securities laws are voidable, an unregistered finder's fee agreement may not be enforceable.

The engagement of an unregistered broker-dealer also exposes the engaging business to considerable risk. It subjects issuers of securities to possible civil and criminal liability. In addition, federal and state securities laws make it unlawful to engage unregistered broker-dealers and securities agents, which violations give investors the right of rescission, effectively granting put rights to the investors. Under certain circumstances, this liability flows through to the officers, directors and other control persons of a company.

## Summary

Due to resource limitations, regulators rarely investigate broker-dealer law violations, absent suspected fraudulent conduct. Most often, the issues arise in the context of investors seeking to rescind failed investments. As the SEC's order illustrates, when the issue does arise securities regulators and lawyers for investors can be expected to disregard form and only consider substance when examining compensation arrangements. The failure to come within the narrow finder's exemption can lead to severe consequences for finders and the businesses that engage them. Individuals considering providing finder services and companies looking to retain the services of a finder should first consult with an experienced securities attorney. ■

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## For More Information

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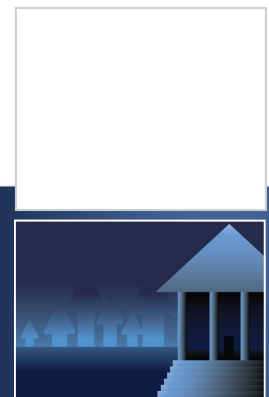
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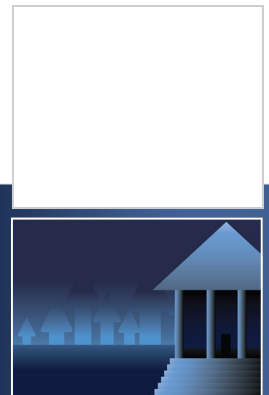
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