

**Broker-Dealer Registration:
Is There a Federal Finder's Exemption?**

by

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Setting precedent.

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Section 15(a)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") provides that "it shall be unlawful for any broker or dealer which is . . . a person other than a natural person . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security... unless such broker or dealer is registered [with the SEC]."

According to Section 3(a)(4) of the Exchange Act, the definition of a broker consists of the following five elements:

- X any person
- X engaged in the business
- X of effecting transactions
- X in securities
- X for the account of others.

In order to determine whether a person or entity acts as a broker, the SEC looks at the activities that the person or entity actually performs. The SEC sets forth three questions, and if the person or entity answers any with a "yes" answer, they may need to register as a broker. The questions the SEC recommends using in this determination are:

- Do you participate in important parts of a securities transaction, including solicitation, negotiation, or execution of the transaction?
- Does your compensation for participation in the transaction depend upon the amount or outcome of the transaction? In other words, do you receive transaction-based compensation?
- Do you handle the securities or funds of others?

Recently, the SEC elaborated on the scope of the definition of a broker. A person effects transactions in securities by participating in such transactions "at key points in the chain of distribution." Such participation includes assisting an issuer to structure prospective securities transactions, and participating in the order-taking or order-routing process. Factors indicating that a person is "engaged in the business" include: receiving transaction-related compensation; holding oneself out as a broker, as executing trades, or as assisting in settling securities transactions; participating in the securities business with some degree of regularity; and soliciting securities transactions. BondGlobe, Inc., 2001 SEC No-Act. Lexis 140 (February 6, 2001).

The Finder Exception to the SEC's Broker-Dealer Registration Requirements

In the 1970's, the SEC took the position that in certain circumstances a finder does not actually engage in the purchase and sale of securities and, consequently, should not be considered a broker. "[W]e have indicated that an intermediary who did nothing more than bring merger or acquisition-minded people or entities together and did not participate in negotiations

or settlements between them probably would not be a broker in securities and not subject to the registration requirements of Section 15 of the Exchange Act.” Henry C. Goppelt dba May-Pac Management Company, 1974 SEC No-Act. LEXIS 2,415 at 2-3 (May 13, 1974).

The SEC narrowly tailored the circumstances in which a finder is not considered a broker. If the finder takes too active of a role in the investment transaction, the finder will be considered a broker by the SEC. “On the other hand, an intermediary who plays an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities generally would be deemed to be a broker and required to register with the Commission.” Id. at 3.

The SEC required a finder to register as a broker-dealer when it appeared that the finder did more than merely act as a finder in bringing together parties to transactions involving the purchase and sale of securities. The SEC noted that the finder:

- X proposed to negotiate agreements involving transactions in securities;
- X engaged in further activities to consummate the transactions, such as assisting the client in providing background and other financial information, arranging meetings, formulating offers and assembling incidental documents;
- X advised the selling client on any offer received; and
- X received a commission based on the total consideration received by the seller.

Mike Bantuveris, 1975 SEC No-Act. LEXIS 2,158 at 1-2 (October 23, 1975); *see also* May-Pac Management Corporation, 1973 SEC No-Act. LEXIS 1,117 at 1, 3-4 (December 20, 1973).

Involvement in negotiations and the transaction.

In the mid-1980’s, the SEC took a broader, more permissible view of finders, exemplified by a no-action letter to Dominion Resources, Inc. in 1985. The staff specifically points to the following set of proposed finder activities as acceptable finder activities:

- analyze the financial needs of an issuer;
- recommend or design financing methods and securities to fit the issuer’s needs;
- recommend a bond lawyer, underwriters, or broker-dealers for the distribution or marketing of the securities in the secondary market;
- participate in negotiations;
- introduce an issuer to a commercial bank to act as the initial purchaser of securities and as a stand-by purchaser if the securities could not be readily marketed by a broker-dealer;

- recommend a commercial bank or other financial institution to provide a letter of credit or other credit support for the securities; and
- receive a negotiated fee that would generally not be payable unless the financing closed successfully and that would not be based on the successful issuance of securities to the public.

The SEC advised Dominion Resources that:

[The finder] will not bid on any issues of securities nor will it underwrite, trade or hold funds or securities of the issuer. Representatives of [the finder] will be available, as requested by the issuer, for consultation regarding the terms of the financing, preparation of the official statement and other matters leading to the closing, and in such capacity as consultant, may participate in discussions and meetings prior to the closing among the issuer, issuer's counsel, bond counsel, the underwriter or broker-dealer, authority counsel, and any commercial bank standby purchasers. At any meetings prior to and including the closing, [the finder] will provide financial advice consistent with its role as a consultant, but will have no authority to represent any of the parties in the negotiations or to bind them to the terms of any agreement. While [the finder] might, upon occasion, as part of the consultative, advisory and negotiating process articulate, explain or defend negotiating proposals or positions that have been adopted by its client or that [the finder] had recommended for its client's adoption, [the finder should,] under all circumstances, act only on behalf of its client and subject to the discretion of its client and [should] not act as an independent middleman generally between the parties. Dominion Resources, Inc., 1985 SEC No-Act. LEXIS 2,511 at 5-6 (August 22, 1985).

Following its position in its 1985 no-action letter to Dominion Resources, Inc., the SEC did not require broker-dealer registration of a finder, acting as a business broker, whose activities consisted mainly of selling businesses that were going concerns. International Business Exchange Corporation, 1986 SEC No-Act. LEXIS 3,065 at 1-2. The SEC based its decision on the following factors:

- X the finder had a limited role in negotiations between the purchaser and seller;
- X the businesses represented by the finder were going concerns and not "shell" corporations;
- X only assets were advertised or otherwise offered for sale by the finder;
- X transactions effected by means of securities conveyed all of a business's equity securities to a single purchaser or group of purchasers formed without the assistance of the finder;

- X the finder did not advise the two parties whether to issue securities or assess the value of any securities sold;
- X the finder's compensation did not vary according to the form of conveyance (i.e., securities rather than assets); and
- X the finder did not assist purchasers in obtaining financing, except to the extent of providing a list of potential lenders, such as banking and venture capital firms, that expressed an interest in extending credit, at the request of the purchaser or seller.

Id. at 5-6; *see also* Victoria Bancroft, 1987 SEC No-Act. LEXIS 2,517 at 3 (August 9, 1987). Thus, the SEC deemed a finder who had never negotiated the terms and conditions of acquisitions to be made for securities issued by the acquiring company not to be a broker. International Business Exchange Corporation, 1986 SEC No-Act. LEXIS 3,065 at 1-2.

However, during the early 1990's, the SEC noted that a finder that was "actively involved in securities transactions, by negotiating their terms, providing advice regarding their terms [and] providing other assistance" would be required to register as a broker-dealer. Davenport Management, Inc., SEC No-Action Letter, [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,643 at 77,737 (April 13, 1993). *See, e.g.*, Fulham & Co., 1972 SEC No-Act. LEXIS 4,548 at 1-2 (December 20, 1972) (noting that a finder was considered a broker because the finder arranged the structure of the offerings and in some cases negotiated on behalf of the issuer of the securities).

Recently, the SEC has narrowed its view of what role a finder may play in a transaction. In March, 2000, the SEC reversed the no-action position taken in its 1985 no-action letter to Dominion Resources, explaining that "in the intervening years since its 1985 no-action letter, technological advances, including the advent of the Internet, as well as other developments in the securities markets, have allowed more and different types of persons to become involved in the provision of securities-related services," and noting that the staff has taken more narrow views of finders in recent years. Dominion Resources, Inc., 2000 SEC No-Act. LEXIS 304 at 3 (March 7, 2000). In the 2000 no-action letter to Dominion Resources, Inc., the staff clearly points out that it has reversed its position and no longer finds that an entity conducting the activities described in the August 22, 1985 letter to Dominion Resources would be exempt from registration as a broker-dealer under Section 15 of the Exchange Act. Dominion Resources, Inc., 2000 SEC No-Act. LEXIS 304 at 3 (March 7, 2000). In reversing its grant of no-action relief, the staff specifically points to the same proposed finder activities as it had in its 1985 no-action letter:

- analyze the financial needs of an issuer;
- recommend or design financing methods and securities to fit the issuer's needs;
- recommend a bond lawyer, underwriters, or broker-dealers for the distribution or marketing of the securities in the secondary market;

- participate in negotiations;
- introduce an issuer to a commercial bank to act as the initial purchaser of securities and as a stand-by purchaser if the securities could not be readily marketed by a broker-dealer;
- recommend a commercial bank or other financial institution to provide a letter of credit or other credit support for the securities; and
- receive a negotiated fee that would generally not be payable unless the financing closed successfully and that would not be based on the successful issuance of securities to the public.

Dominion Resources, Inc., 2000 SEC No-Act. LEXIS 304 at 1-2.

Receipt of commissions.

The SEC also considers the fee arrangement of the finder in reviewing any registration requirements. In the past, the SEC has generally taken the position that if the finder receives a commission based on the consideration of the transaction, the finder is not exempt from registration as a broker. Fulham & Co., 1972 SEC No-Act. LEXIS 4,548 at 1-2 (December 20, 1972). However, in the 1985 no-action letter to Dominion Resources, the staff did not object to fees charged by the finder for its consultative and coordinating services which were negotiated with the issuer and were related to the overall size of the financing that the client wished to arrange, and generally were not payable unless the financing closed successfully. The staff added that the finder's fees were not based upon successful issuance of securities to the public or affected by secondary trades thereafter. Dominion Resources, Inc., 1985 SEC No-Act. LEXIS 2,511 at 7 (August 22, 1985).

Recently, however, the SEC has narrowed its position regarding finder's fees to disallow all transaction-related compensation. The staff reversed its position regarding no-action relief for Dominion Resources, Inc., noting that because the finder planned to receive a negotiated fee that would generally not be payable unless the financing closed successfully, the finder is not exempt from broker registration. Dominion Resources, Inc., 2000 SEC No-Act. at 2 (March 7, 2000). The SEC's current view regarding a finder's receipt of commissions is that if a finder's fee is contingent upon the consummation of the transaction, the finder is not exempt from registration as a broker. BondGlobe, Inc., 2001 SEC No-Act. Lexis 140 (February 6, 2001).

The SEC has not required the registration of a finder when the finder's compensation is not contingent upon a transaction. For example, the SEC did not require registration when a finder's compensation did not vary or depend on the size or success of a securities offering or transaction, and the price for goods and services provided by the finder to program participants did not vary from that charged to non-participants. Stockback.com, LLC, 2000 SEC No-Act. LEXIS 762 at 3 (July 28, 2000).

Consequences of Failing to Properly Register as a Broker-Dealer

The failure of a broker to register with the SEC could subject the broker to monetary penalties and to certain injunctive actions by the SEC, pursuant to Section 21 of the Exchange Act. The SEC is authorized to seek civil injunctions in federal district court against persons violating or about to violate the provisions of the Exchange Act, including the broker registration requirements. The SEC may seek civil money penalties as well. The SEC also has the authority, after notice and opportunity for hearing, to issue a cease-and-desist order in response to a violation of these provisions. In addition, the SEC is authorized to refer the matter to the Attorney General for prosecution. Finally, failure to register when required is grounds for denial by the SEC of a later application for broker registration. *The "Finder's" Exception From Federal Broker-Dealer Registration*, John Polanin, Jr., 40 Cath. U.L. Rev. 787 (1991), 792-793.