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# Recent court and SEC actions suggest heightened scrutiny for finders

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A recent U.S. Securities and Exchange Commission ("SEC") enforcement action and a recent New York state court decision confirm that individuals that act as "finders" in securities offerings will be the subject of increased scrutiny. A "finder" is a person who acts as an intermediary in a private or public offering of securities for consideration and who does so without compliance with the federal broker-dealer regulatory regime. The SEC action and the New York state court ruling have highlighted concerns that such individuals are violating federal (and in some cases, state) securities laws by failing to register as a broker and that increased judicial scrutiny and SEC enforcement actions will be forthcoming.

Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act") defines a broker as any person engaged in the business of effecting transactions in securities for the account of others. Section 15(a) of the Exchange Act requires that all brokers register as such with the SEC and become a member of a self-regulatory organization. The Exchange Act does not contain an exemption from registration for "finders." Until March, 2000 the SEC and its Staff turned a blind eye to the failure of so-called finders to register, and countenanced the failure to register provided that certain conditions were met. Those conditions were set forth in a number of No-Action Letters, the most notable of which was issued to Dominion Resources, Inc.[1] Those No-Action Letters had served as a template for those that wished to act as a finder without having to comply with the broker/dealer registration provisions of the Exchange Act. With the onset of cheap and ubiquitous electronic communications, the Commissioners of the SEC became increasingly concerned with the damage that could be done by finders through the use of the Internet, email blasts and similar communications, and accordingly in March, 2000 the SEC withdrew the No-Action Letter that it had issued to Dominion Resources, Inc. and others like it and stated that the only No-Action relating to finders that was not being withdrawn was the No-Action Letter issued on July 24, 1991 to Paul Anka[2].

The relief granted to Paul Anka was extremely narrow. The SEC Staff granted Anka's request for noaction relief from broker-dealer registration in connection with his proposal to merely provide his rolodex to the entity (a hockey team) raising money so that it could locate investors and attempt to raise money through an offering of its partnership units. The SEC Staff took the position that "registration is not required for an individual who does nothing more than furnish to an issuer-offeror the names of persons the individual believes are potential investors in return for a transactional based finder's fee." The circumstances covered by the Paul Anka No-Action Letter involved an isolated event, did not involve the payment of a contingent fee or the payment of a percentage of the proceeds raised, and did not involve any direct solicitation of a potential investor by Paul Anka. Thus the Paul Anka letter presents little if any comfort for individuals that act as finders.

Since the withdrawal of the Dominion Resources, Inc. No-Action Letter, the Staff of the SEC has been warning the public that violation of the broker registration requirements would not be tolerated and that regulatory actions against unregistered individuals acting as finders could be expected. The Staff has made clear that the items that cause it the greatest concern are finders' involvement in the sales process, their negotiation of any resulting transaction, their involvement in the delivery of the securities and/or the proceeds paid therefore, their receipt of compensation that is contingent upon a sale of securities and their receipt of compensation that is calculated on the basis of a percentage of the proceeds of securities sold. It is the view of the SEC and its Staff that these hallmarks represent circumstances in which the finders have incentives to misstate or omit to state material facts to prospective investors and highlight the need for the protections afforded to the public by registration and regulation as a broker.

On April 30, 2008, the SEC issued an Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions (the "Order") against Robert MacGregor. The Order found that from November 2003 through at least January 2005, MacGregor was employed by and associated with Duncan Capital LLC ("Duncan"), a registered broker-dealer. During his employment and association with Duncan, MacGregor conducted brokerage activities for Duncan in connection with private investments in public equity. MacGregor received commissions based on the dollar amount of the placement as compensation for his activities. At no time during his employment and association with Duncan was MacGregor registered with the NASD as a broker, nor had he passed the examinations required in order to conduct the activities he was performing for Duncan. On April 11, 2008, the SEC entered a final judgment against MacGregor barring him from association with any broker or dealer for at least one year and requiring him to disgorge all ill-gotten gains obtained in connection with his violations of the registration requirement.[4] While the SEC's action may be viewed as an action against an associated person of a broker-dealer who engaged in activities not allowed by an associated person absent appropriate licenses, viewing the action that narrowly would be to ignore the clear message being sent by the SEC. If a person associated with a broker-dealer (which is itself appropriately licensed and subject to oversight) is subject to such significant sanctions for failure to be appropriately licensed in connection with the private placement of securities, where does that leave a finder who acts in blatant disregard of the regulatory framework?

On April 1, 2008, just days prior to the SEC's final judgment against MacGregor, the Supreme Court of New York County in New York issued a decision in *Torsiello Capital Partners v. Sunshine State Holding*, finding against an unregistered broker who sued an affiliate to collect a fee for performing brokerage services[5]. The plaintiff, Torsiello Capital Partners ("Torsiello"), entered into an agreement with Sunshine State Holding Corporation ("Sunshine") to act as sole agent for the private placement of Sunshine's securities in exchange for a fee equal to 3.5% of the total purchase price on the sale of Sunshine, as well as a retainer fee. Specifically, Torsiello's obligations under the contract were to "render financial advisory and investment banking services to [Sunshine], on an exclusive basis, in connection with reviewing [Sunshine's] capital structure, as sole agent for a private placement of equity or equity-linked securities or debt."

Although Torsiello failed to locate a purchaser for Sunshine, Torsiello sued Sunshine to enforce the contract and collect its fee. The primary issue addressed by the court was whether Torsiello was required to be registered as a broker under the federal securities laws in order to perform its obligations under the contract with Sunshine. The court noted that "the SEC has opined in a no-action letter that 'a professional who brings together potential buyers and sellers and advises the parties on questions of value, plays an integral role in negotiating the transaction, or provides other services designed to facilitate the transaction, may be deemed to be a broker'"[6] for purposes of the registration requirements of Section 15(a) of the Securities Exchange Act of 1934. The court found that the record clearly demonstrated that Torsiello "was retained to act, and did act, as a securities broker with regard to the marketing and proposed private sale of Sunshine's securities." Accordingly, the court held that the contract between the parties was void and rescindable by Sunshine because Torsiello was not registered as a broker, and therefore, could not legally perform its contractual obligations under the contract.

The actions by the SEC and the New York state court suggest that regulators and the judiciary are becoming increasingly concerned about and intolerant of the activities of unregistered finders, and that the scope of activities in which a finder may participate while unregistered will become increasingly constrained. The SEC Staff is currently working on drafting a registration scheme for private placement brokers and has expressed an intention to submit the same to the Commissioners for their consideration in the near future.[7] Until that time, finders should carefully evaluate their activities in connection with arranging private placements to determine whether they are at risk of violating the federal securities laws.