REPORT AND RECOMMENDATIONS OF THE TASK FORCE ON PRIVATE PLACEMENT BROKER-DEALERS

VERY ROUGH DRAFT - HHM
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This Report and Recommendations has been prepared by a Task Force of designated representatives from the Business Law Section Committees on Federal Regulation of Securities, Negotiated Acquisitions, Small Business and State Regulation of Securities. The Task Force was created in response of a widely held perception by many members of the Business Law Section that individuals or entities acting as finders constituted a major problem in corporate finance transactions and in the area of mergers and acquisitions. Many of these persons were unregistered broker-dealers under federal and state securities laws, and accordingly transactions were jeopardized because of the use of the unregistered/non-exempt finder. Further, some of these individuals had very adverse regulatory histories or were closely affiliated with those who had, and some had been barred or suspended from broker-dealer or agent registration by regulators.

Finders must be viewed from multiple perspectives. They are found in transactions ranging from active solicitation of investors in private offerings to passive introduction in sale of asset transactions. This is not an environment in which ones size fits all. That dichotomy requires an analysis of the different aspects of finders activity, and suggests that solutions should be modeled to address the components of finder's activities rather than creating a single solution.

The perception of many members is that the vast preponderance of finders in private corporate or similar finance transactions are in reality unregistered broker-dealers. These individuals and entities avoid registration for a variety of reasons expressed to many members of our Section over time, including:

- Forms and rules required of conventional broker-dealers that have little to do with their activities.
- Required tests have even less to do with their activities.
- Belief that regulators have little or no enforcement interest in their activities.
- Little fear of loss of commissions in legal action.
- Misinformation provided by counsel with lack of understanding of, or indifference to, securities laws and the interpretations of the SEC and the states.
- Inability to comply because of regulatory orders preventing entry into the business in a legitimate fashion.

- Past transactions which would result in punishment and adverse publicity if one sought to register.

There is another side to the finder role. Financial intermediaries can provide invaluable assistance in locating parties for merger and acquisitions transactions, and can provide access to capital, particularly for small business, which the brokerage community nationally does not presently serve in an effective fashion.

This has led us to the conclusion that finders, or financial intermediaries, play an important role but that there are serious problems which must be addressed to ensure that they do so in a legal and proper manner, and that those who bring scams, shell corporations, and bad regulatory histories are clearly and emphatically precluded from engaging in these activities.

The present regulatory system is not effectively achieving this objective. The SEC has brought few cases in this area, and while the rhetoric of the Division of Market Regulation has been strongly adverse to the use of financial intermediaries, there has been little effective communication to either the bar or the business in world in general on this subject. This vacuum of effective communication serves as an encouragement for those who would avoid the law. Simply putting out a no-action letter does very little for those who do not use experienced securities counsel. We will recommend more effective communication from the SEC as outlined below in RECOMMENDATIONS.

The regulatory system also fails in another respect. The broker-dealer registration process is not well designed for those whose primary role is to provide introductions and have a very limited role in the actual funding process. Much of the system is presently designed for a full service broker-dealer, or a specialist in particular segments. None of those segments meet the needs of those who engage in finders activity across a range of entities. If we are to encourage compliance, reform of that system by the SEC, states and the NASD will be an important first step. This Report includes suggestions in Recommendations below.

We believe that expanded consideration should be given to expanding and solidifying the "safe harbors" evidenced by the no-action letters to provide clear guidance to the public regarding permissible conduct, and that such consideration should be based on a re-examination of the need to regulate certain types of conduct, as set out further in the Recommendations.

Finally, for this effort to bring about wide-spread compliance , consideration should be given by the states to providing a temporary hiatus in the procedures used by some states to inquire into the prior activity of entities and individuals before registering as broker-dealers. The primary objective should be aimed at getting a large number of entities and individuals into compliance, not on seeking out those who were not previously in compliance. In the Recommendations, we suggest precedent for such a procedure.

I. PUTTING THE PROBLEM INTO PRESPECTIVE.

Often in both acquisitions and business financings lawyers learn that finders are present. They can be both a blessing and a curse. As a source of funds otherwise unavailable to a client, or as the catalyst that leads to a successful acquisition, they are a boon to finance. As a purveyor of bad deals, bad relationships, securities law violations and the potential for rescission, they represent a major threat not only to the client but also to the professionals working with the client.

At their worst, finders are the poltergeist of business. Finders appear at the beginning of an offering and have engaged in general advertising or solicitation before the attorneys arrive. They can be the purveyors of that most worthless product in the securities industry - the "clean shell." They can bring to the transaction the market manipulators and profiteers whose only interest is the fast buck regardless of the consequences to the company or its investors. They can cause offers or sales to occur without regard to compliance with the very requirements of the securities offering exemptions they purport to rely on when advising an issuer.

The definition of a "finder" is elusive and, indeed, it varies under the circumstances. In *Use and Compensation of 'Finders' To Locate Purchasers in Private Placements*,[1] the term is defined as "a person, be it a company, service or individual, who brings together buyers and sellers for a fee, but who has no active role in negotiations and may not bind either party to the transaction." The definition should be expanded to state "that the person should neither offer nor sell the security, nor solicit an offer to buy, but rather act strictly as an intermediary for the purpose of introducing the parties" to underscore this all too common problem.

The State of Michigan is the only state to register a finder, defining a finder as "a person who, for consideration, participates in the offer to sell, sale or purchase of securities by locating, introducing or referring potential purchasers or sellers."[2] Michigan presently requires a finder to register as an investment adviser and imposes minimum requirements on the finder's

[1] Alan J. Berkeley and Alissa J Altongy, Regulation D Offerings and Private Placements, SF71, ALI-ABA (2001) at 51. (Hereinafter "Berkeley".)

[2] Michigan Uniform Securities Act, Section 401(u).

method of operations.[3] Michigan generally expects the finder to perform the introduction, possibly deliver the offering materials, and then step away from the transaction.

The principal risk to the finder and the issuer is that the finder is in reality acting as an unlicensed broker-dealer. The Securities and Exchange Commission ("SEC") has issued several no-action letters outlining the parameters of a finder's acceptable conduct, or declining to find conduct acceptable, in conjunction with the offer or sale of a security. Alan Berkeley[4] lists the factors which move one to the status of a broker-dealer as involvement in negotiations, discussing details regarding the transaction or making a recommendations, receiving transaction-based compensation, and previous involvement in the sale of securities.

There has been a rumor rampant among the securities bar that the SEC is contemplating pulling one or more of the no-action letters which have provided some latitude to finders. On March 7, 2000, the staff of the Division of Market Regulation withdrew its letter in *Dominion Resources*, which had permitted Dominion to engage in a bundle of activities. The activities previously acceptable to the SEC in that letter included analyzing the financial needs of an issuer, recommending or designing financing methods and securities to fit the issuer's needs, recommending the lawyers to prepare documentation and broker-dealers to distribute the securities, participating in negotiations, and introducing the issuer to a commercial bank to act as the initial purchaser and as a stand-by purchaser if the securities could not be readily marketed. In return for these services, *Dominion* received a transaction based fee.

The aura of uncertainty is one of the factors motivating a decision to better address the regulation of finders. For the past two years the Small Business Committee of the Business Law Section has been working to develop a regulatory scheme for finders which could be proposed to the SEC, NASDR, and NASAA.

A. A Need For Action.

A variety of factors drive the need for action. The broker-dealer universe is shrinking both in terms of the number of firms and the scope of services that they render. With bank acquisitions, consolidations of regional firms, and loss of firms in the current economic downturn, the void of investment banking services, particularly for mid to small size issuers, has dramatically worsened. Smaller brokerage firms are focusing on mutual funds and variable products, especially after the economic bath that many took if they promoted technology,

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[3] Michigan Uniform Securities Act, Section 102(c) sets forth seven requirements applicable to finders, including a prohibition on taking possession of funds or securities; failing to disclose the finder relationship and compensation as well as any beneficial interest in the offering or issuer; knowing participation in an offering in violation of the registration requirements for securities, after reasonable inquiry; participation without obtaining information relative to the risks of the offering, compensation, financial condition and use of proceeds, and failure to review offering materials provided by the issuer prior to recommendation; failure to disclose material information which the finder knows or should have known based on material information available to the finder; and making an introduction of a person who is not suitable for the investment. The finder is not required to independently generate information.

[4] Ibid. at n. 1

communications and .com stocks. The self-imposed thresholds for doing private deals is rising for economic reasons. The result is that very few brokerage firms are willing to do offerings, public or private, under $25 million. There are several rationale for this position. The risk of doing a small deal is often similar to a large one. The legal costs are often comparable to a larger transaction because of the lack of sophistication and systems of smaller issuers. The issuer's financial and other information may not be as complete or accurate. Finally, the smaller the company, the less diversification it can provide to an investor in terms of product range and depth of personnel and markets.

Venture capital is not the answer for this void. Venture firms are trending to investment in profitable businesses and there has been a drop in available funds. Many venture capitalists got burned in tech and related stocks and their investors are more risk adverse. This year some venture capital funds have been returning their investors' monies for inability to find enough satisfactory investments. Further, the high yield requirements for venture capitalists are frequently incompatible with the potential of the preponderance of smaller issuers. Finally, there are too few venture capital funds to have a significant impact on fulfilling the need for funds.

The traditional financing sources for smaller issuers remain limited. Most issuers engage in "cup of gas" financing, seeking enough funds to move their project down the road, but not getting the funds to really develop their business. These issuers run through the chain of friends and family, to customers, to suppliers, to extended contacts, and then often run out of alternatives for growth.

Laying in wait for these small issuers amidst the dark side of the securities business are the purveyors of shell corporations, the front-end fee con artists, the Reg S specialists who send the stock off-shore and wait to dump it back into the US through unscrupulous brokerage firms or representatives who are receiving under-the-table payments for promoting stocks, the micro-cap manipulators, and the representatives who have been barred from the securities business. All of these options will likely cost the issuer dearly, even if promised funding is received from them. Often these individuals and entities hold themselves out as finders and aren't registered as broker-dealers. The cost to the issuer and insiders of the company of what these finders bring to the table often far exceeds any funds they produce.

B. Who Are the Finders?

Finders come from a variety of sources. They include CPAs and to a lesser extent lawyers, M&A specialists, business brokers, local "monied people" (the country club set), consultants (who take a variety of forms), insurance agents and real estate brokers, registered representatives illegally selling away from their firms, individuals who have substantial investor networks or the people that work for such individuals, individuals hired by entities seeking capital, angel networks, retired executives and community leaders. They also include unregistered individuals who hold themselves out as finders and do this for a living by providing business plans, private placement memoranda, and who remain as paid consultants.

Members of the section have observed a significant number of attorneys who provide opinions giving comfort to finders, while ignoring SEC no-action letters and federal and state enforcement actions leading to a different conclusion. Generally these individuals are solo or small firm practioners with very limited securities experience and either no appreciation for the complexity of the analysis or a willingness to render opinions to accommodate a client.

C. What Problems Does One Confront When Using a Finder?

Finders can cause major problems for an issuer. They can taint an offering by creating the basis for rescission rights, raise enforcement concerns, make fraudulent representations and engage in general solicitation. These issues are discussed in the section on Litigation Issues below. They can be individuals who have been suspended or barred from the securities business or fired by firms for misconduct. There are those who act in collusion with market manipulators and those who bribe registered representatives to act as touts. These individuals lead invariably to litigation when the deal goes bad, as it frequently does.

Finders can provide encouragement to cut legal corners. They often underprice legitimate firms or deter issuers from going to legitimate firms. For an attorney, they are a major concern, since their actions adversely affect opinions that we are asked to render and harm our clients.

These individuals often lead the issuer down a primrose path with false promises. They may add to the issuer's existing problems, create significant litigation or raise an enforcement action risk. The finders' contracts can be incredibly over-bearing, significantly hampering future financing for the issuer. After funding, issuers may find themselves faced with very unhappy investors who are angry over misrepresentations by the finders, and who demand rescission or the buy-out of their shares. Those investors may also apply pressure to the issuer to make a corporation "go public" or qualify its shares for trading on the Nasdaq Bulletin Board or Small Cap market before the company is prepared to take that step from a financial, management sophistication, or regulatory filing capability perspective.

Regulators have a substantial concern over the "finders" who flaunt the securities laws. We estimate that the various states bring well over 100 enforcement cases against improper finders on an annual basis (and probably a great deal more because statistics are not available from NASAA or the states to identify the full extent of state action). The NASDR brings a large number of cases against individuals who are engaged in selling away from their brokerage firms for acting as "finders," often barring them from the business or imposing long suspensions. This is the second most frequently cited grounds for sanctioning registered representatives and has been for several years. The NASDR monthly Notice To Members which lists enforcement actions contains "selling away" allegations in virtually every issue. These actions represent only the tip of the iceberg of that problem.

The illegitimate finders, who are really unlicensed broker-dealers, were the direct cause of the SEC action in restricting the scope of Regulation S and Rule 504 two years ago. Regulators are also unhappy to find that the people that they have expelled from the business have resurfaced in a new guise.

Today so-called finders are active in soliciting investors for a range of products which have been held to involve securities, including pay phone leases, viatical or life settlement contracts, promissory notes, foreign CDs, and "prime bank" scams.

D. M&A Concerns.

Finders play an important role in the mergers and acquisitions ("M&A") practice, often bringing parties together when other conventional sources have been unable to do so. Even those who bring this benefit to the table can also bring problems, as they edge closer to the role of the broker-dealer in getting transaction-based compensation for bringing in venture capital, angels, institutional investors, or loans from non-commercial sources to assist in a management buy-out.

The SEC has carved out realistic guidance in this area, as discussed in Merger and Acquisitions below. Again, our Recommendations suggest an expanded distribution of this guidance.

E. The Search For Certainty.

For the lawyer asked to render opinions in conjunction with financing transactions or acquisitions involving fees for obtaining financing, we seek reasonable certainty. Tainted transactions are harmful to all parties involved, including investors.

The problem with certainty is that the present system really does not work well for regulating finders. Often finders play a very limited role in transactions, but in order to engage in transactions presently, full broker-dealer registration is required in a manner more appropriate to a full-service firm. Consequently, finders often state that they refuse to register under a system that has no real applicability to what they do.

The response of the Task Force is to work with the SEC, NASDR and the states, through NASAA, to develop a regulatory system that works more effectively. This entails modifying existing procedures, forms, rules and systems to adapt them to what finders really do and to encourage registration as broker-dealers when they fall outside of safe harbors. At the same time, the Task Force encourage systems to identify those individuals or entities who are "bad boys" or statutorily disqualified persons. WE believe that it is likely that the SEC will be more aggressive in the future in policing unregistered broker-dealers. Under the most logical sequence, when the new form of broker-dealer is established, the SEC and NASAA would issue clarifying releases on the role of finders and the new broker-dealer registration procedures.

II. EXCEPTIONS TO REQUIRED BROKER-DEALER REGISTRATION.

Within a very narrow scope of activities primarily described in SEC no-action letters, a person may perform certain limited activities without triggering broker-dealer registration requirements. In interpreting their own securities laws, states generally, but not always, follow a similar analysis. These limited exceptions to broker-dealer registration are entirely constructions of regulatory interpretation and are not explicitly recognized in federal or state securities laws (Michigan being the only exception). The SEC and state securities regulators are free to modify the scope of these limited exceptions at any time. In fact, in recent years the SEC has been narrowing the permitted scope of finder activities. Indeed, in the last two years the SEC staff has not only expressly limited the scope of one well-established exception but has withdrawn another significant no-action letter relied upon by many finders in structuring their arrangements with securities issuers citing, among other things, advances in technology that have permitted other types of persons to become involved in securities-related activities.

A. Finders.

The SEC has by no-action letter defined the contours of finder's exceptions, though as discussed below those contours are presently in flux. It is in this context of finders the SEC has articulated many of its guiding policy concerns.

Although no single factor is dispositive of the question of whether a finder is engaged in the activities of a broker-dealer, SEC no-action letters reveal a variety of factors that are typically given some weight by the staff including: (1) whether the finder was involved in negotiations; (2) whether the finder engaged in solicitation of investors; (3) whether the finder discussed details of the nature of the securities or made recommendations to the prospective buyer or seller; (4) whether the finder was compensated on a transaction-related basis; and (5) whether the finder was previously involved in the sale of securities and/or was disciplined for prior securities activities. See Alan J. Berkeley and Alissa A. Parisi, Frequently Asked Questions About the Resale of Restricted Securities (ALI-ABA 2002); David A. Lipton, A Primer on Broker-Dealer Registration, 36 Cath. U. L. Rev. 899, 914, 927 (1987).[5] A review of these individual criteria provides some guidance as to the range of permissible conduct.

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[5] There is no indication that a transaction's status as a public offering, as opposed to a private placement, has any impact on the Staff's interpretation of the broker-dealer registration requirements. Compare NFC Petroleum, SEC No-Action Letter (July 17, 1978) (applying standards discussed herein to finder engaged in public offering), with Dana Investment Advisors, Inc., SEC No-Action Letter (October 12, 1994) (applying same standards in context of private transaction).

a. **Transaction-Based Compensation**.

Transaction-based compensation has come under intense scrutiny by the SEC. The SEC's Division of Market Regulation has repeatedly noted that:

> . . . [T]he receipt of compensation related to securities transactions is a key factor that may require an entity to register as a broker-dealer. Absent an exemption, an entity that receives securities commissions or other transaction-based compensation in connection with securities-based activities that fall within the definition of "broker" or "dealer" generally is itself required to register as a broker-dealer. Registration helps to ensure that persons who have a "salesman's stake" in a securities transaction operate in a manner that is consistent with customer protection standards governing broker-dealers and their associated persons. That principle not only encompasses the individual who directly takes a customer's order for a securities transaction, but also any other person who acts as a broker with respect to that order, such as the employer of the registered representative or any other person in a position to direct or influence the registered representative's securities activities.

Herbruck, Alder & Co., SEC No-Action Letter (June 4, 2002); see also, e.g., Birchtree Financial Services, Inc. (SEC No-Action Letter Sept. 22, 1998) (registered representative's personal service corporations); 1st Global, Inc. (SEC No-Action letter May 7, 2001)(unregistered CPA firms); Wirthlin; Richard S. Appel, SEC No-Action Letter (Feb. 14, 1983) (1031 exchange transactions; requiring registration because finder would receive commission-based compensation on sales).

Transaction-based compensation triggered broker-dealer registration in Mike Bantuveris, SEC No-Action Letter (Oct. 23, 1975), where the company wished to offer a consulting service in which it would identify companies as possible acquisition candidates and assist its clients in negotiating toward a final agreement. The company proposed to base its fees, in part, on the total value of consideration received by the sellers or paid by the buyers. On these facts, the staff indicated that the company would be required to register as a broker-dealer. The staff noted that its opinion was "based primarily on the fact that the consulting firm would . . . receive fees for its services that would be proportional to the money or property obtained by its clients and would be contingent upon such transactions in securities." See also John M. McGivney Securities, Inc., SEC No-Action Letter (May 20, 1985).

The SEC has left open whether a commission-like fee arrangement, standing alone, will always constitute grounds for registration as a broker-dealer. Paul Anka, SEC No-Action Letter (July 24, 1991), provides the unusual case where a commission-like fee has

been allowed to stand (for the moment). The staff's favorable position would appear to be attributable to the uniquely limited duties of the finder involved in the case and to the one-time occurrence of the event. In Anka, the Ottawa Senators Hockey Club retained entertainer Paul Anka to act as a finder for purchasers of limited partnership units issued by the Senators. Anka agreed to furnish the Senators with the names and telephone numbers of persons in the United States and Canada whom he believed might be interested in purchasing the limited partnership units. Anka would neither personally contact these persons nor make any recommendations to them regarding investments in the Senators. It is noteworthy that in Mr. Anka's original proposal letter to the SEC he would have made the initial contact with prospective investors, but the SEC would not issue a no-action letter under those facts. In exchange for his services, Anka would be paid a finder's fee equal to 10 percent of any sales traceable to his efforts. Important factors identified in the Anka letter include:

- Mr. Anka had a bona fide, pre-existing business or personal relationship with these prospective investors.
- He reasonably believed those investors to be accredited.
- He would not advertise, endorse or solicit investors.
- He would have no personal contact with prospective investors.
- Only officers and directors of the Senators would contact the potential investors.
- Compensation paid to the Senators' officers and directors would comply with SEC Rule 3a-1 (governs compensating issuer's agents).
- He would not provide financing for any investors.
- He would not advise on valuation.
- He would not perform due diligence on the Senators' offering.
- He had never been a broker-dealer or registered representative of a broker-dealer.

The SEC indicated that it would not recommend enforcement action if Anka engaged in the proposed activities without registering as a broker-dealer.

While the SEC did not comment, it would appear that the staff was willing to tolerate the commission-like structure of Anka's fee arrangement because his role in finding prospective purchasers--which was limited to sending a list of names to the Senators--provided no opportunity or incentive to engage in abusive sales practices. See John Polanin, Jr., The "Finder's" Exception from Federal Broker-Dealer Registration, 40 Cath. U. L. Rev. 787, 814 (1991). The SEC staff may be reconsidering whether Mr. Anka's activities sufficiently removed him or others like him from having the opportunity to engage in abusive sales practices that registration is intended to regulate and prevent. The SEC staff may also be reconsidering its position in this letter and might not issue such a letter today. Although the SEC's position in the Anka letter was not premised on the Dominion Resources letter (discussed below and in Section IV), the revocation of Dominion Resources in 1985 seems to demonstrate that the staff is moving to a position where the existence of transaction-based compensation alone may be sufficient to

trigger broker-dealer registration. From the SEC staff's perspective, transaction-based compensation creates the incentive for abusive sales practices that registration is intended to regulate and prevent.

b. Negotiation or Advice.

If the finder is involved in negotiations or has provided detailed information or advice to a buyer or seller of securities, the staff is more likely to require the finder's registration as a broker-dealer. See, e.g., Mike Bantuveris, SEC No-Action Letter (Oct. 23, 1975) (requiring registration); May-Pac Management Co., SEC No-Action Letter (Dec. 20, 1973) (requiring registration); Fulham & Co., SEC No-Action Letter (Dec. 20, 1972) (requiring registration); cf. Caplin & Drysdale, Chartered, SEC No-Action Letter (Apr. 8, 1982) (not requiring registration where finders neither negotiated nor provided advice); Leonard-Trapp & Assocs. Consultants, SEC No-Action Letter (Aug. 25, 1972) (requiring registration). The staff has emphasized that "persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities generally are deemed to be either a broker or a dealer, depending upon their particular activities, and are required to register with the Commission." May-Pac Management Co., supra. But if the finder's participation in negotiations is limited to performing the "ministerial function of facilitating the exchange of documents or information," the staff has indicated that no registration is required. Samuel Black, SEC No-action Letter (Dec. 20, 1976).

For example, no-action relief was denied to May-Pac, a company specializing in mergers and acquisitions, who proposed to seek out potential sellers of corporations, bring them together with potential buyers, and work toward closing the transaction. The company acknowledged that, in most cases, it would participate in whatever negotiations were necessary to close the deal and advise its client as to the quality of any offer received. On the basis of these activities, the SEC concluded that the company would be required to register as a broker-dealer. The staff found that the proposed activities were more than merely bringing together the parties to transactions involving the purchase or sale of securities. The firm proposed to negotiate agreements, engage in other activities to consummate the transactions, and to receive fees for its services that would be proportional to the money or property obtained by its clients and would be contingent upon such transactions in securities.

Alternatively, the SEC granted no-action relief to Victoria Bancroft, a licensed real estate broker, who established lists of clients who might be interested in acquiring financial institutions that are for sale. Victoria Bancroft, SEC No-action Letter (August 9, 1987). The Bancroft letter describes her activities as being "limited merely to the introduction of parties." She did not participate in the establishment of the purchase price or any other negotiations between the parties. The parties created all materials related to either the sale or purchase of the financial institutions without Bancroft's involvement. She didn't even facilitate exchange of the information. At most she described to the potential purchaser the type of institution, the asking price, and the general location. If the potential person were interviewed, Bancroft would arrange

a meeting with the seller or seller's representative. Either the buyer or seller would compensate Bancroft by a flat fee or a percentage of the purchase price. The compensation was considered to be a referral fee or finder's fee.

In granting no-action relief, the staff indicated that (1) Bancroft had a limited role in negotiations between the purchaser and seller; (2) the businesses represented by Bancroft were going concerns and not shell corporations; (3) transactions effected by means of securities will convey all of a business's equity securities to a single purchaser or group of purchasers formed without the assistance of Bancroft; (4) Bancroft did not advise the two parties whether to issue securities or assess the value of any securities sold; and (5) Bancroft did not assist purchasers to obtain financing. The staff further stated that Bancroft would be subject to the anti-fraud provisions of the federal securities law to transactions in which securities are used to transfer ownership of a business. Bancroft is an old no-action letter lacking the details found in more current no-action letters.

c. **Solicitation**.

Solicitation of investors for securities is also a factor that weighs in favor of broker-dealer registration. In Thomas R. Vorbeck, SEC No-Action Letter (Mar. 24, 1974), the SEC required registration where the company proposed to offer a two-part securities service package to its employees in order to cure what it viewed as deficiencies in its employee stock purchase plan.. Under the plan, employees could elect to reduce their commission expenses by assigning the stock to the employer, and/or to increase their profits by authorizing the employer to sell short designated shares of stock once each quarter. On the basis of these facts, the staff indicated that the company would be required to register as a broker-dealer under Section 15(a). As the staff explained, the proposed activities "would appear to bring [the company] within the definition of a broker since it is reasonable to presume that [among other things] . . . the plan would entail some form of solicitation of business on your behalf." See also SEC v. Schmidt, Fed. Sec. L. Rep. 93,202 (S.D.N.Y. 1971) (finder was determined to be a broker-dealer when he placed advertisements in a daily newspaper offering savings on commissions); Joseph McCulley, CCH Fed. Sec. L. Rep., 78,982 (Sept. 1, 1972) (requiring registration based on mere repeated advertising to buy and sell securities).

The SEC has not provided much guidance on what activities constitute solicitation or advertising sufficient to trigger broker-dealer registration under Section 15(a). However, the staff has accepted a finder's use of a cover letter and a press release to notify prospective purchasers of the proposed transaction. See Ewing Capital, Inc., SEC No-Action Letter (Jan. 22, 1985). It is the content and extent of the solicitation, rather than the mode of communication, which will most likely determine the SEC's reaction to a finder's solicitation activities. See, e.g., Victoria Bancroft, SEC No-Action Letter (Aug. 9, 1987); Mike Bantuveris, SEC No-Action Letter (Oct. 23, 1975); F. Willard Griffith, II, SEC No-Action Letter (Oct. 7, 1974).

d. Previous Securities Sales Experience or Disciplinary Action.

Another factor given weight by the staff is whether the finder has previously been involved in the sales of securities and/or disciplined for violations of the securities laws. The SEC wants to be certain that the finder exception is not a "backdoor" for past violators barred from the industry to remain involved and put investors at risk. Accordingly, previous involvement of in the securities industry increases the likelihood that the finder will be required to register as a broker-dealer. An interesting example of this is Rodney B. Price and Sharod & Assocs., SEC No-Action Letter (Nov. 7, 1982). In Price, the usual indications of broker-dealer status seemed to be lacking. The finder was retained to locate brokers and dealers as potential underwriters or participants in private offerings. The finder was to have no involvement in actual selling efforts, and his fee was not based on commissions tied to sales.

While the staff did not directly attribute this opinion to the finder's prior securities activities and disciplinary history, the letter began by describing at length the fact that the finder had previously engaged in the sale of securities and that he had recently been disciplined for violations of the Act. Since nothing in the nature of the finder's proposed activities would otherwise seem to have necessitated registration as a broker-dealer, it is fair to conclude that the staff's decision was motivated by the finder's previous securities activities. Cf. Carl L. Feinstock (John DiMeno), SEC No-Action Letter (April 1, 1979) (stating initially that the finder, who was to receive commissions tied to sales, had to register but then changing its opinion after being informed in a follow-up letter that the finder had "not previously been engaged in any private or public offerings of securities").

In 1998, the SEC brought an action against Michael Milken and MC Group for allegedly violating the broker-dealer registration provisions of the federal securities laws. In its complaint, the SEC alleged that MC Group, through Milken and others, acted as business consultants, introduced companies, suggested business arrangements between them, participated in negotiations regarding the structure of transactions, and received transaction-based compensation in the amount of $42 million. The SEC further alleged that as a result of this conduct Milken violated the SEC's March 11, 1991 order prohibiting Milken from associating with a securities broker, and is liable for MC Group's violations of the Exchange Act because he directly and indirectly controlled MC Group.

Milken and MC Group consented to settle the action, without admitting or denying the allegations. They also agreed to disgorge the $42 million earned from the transactions and prejudgment interest of $5 million. The final judgment commands Milken to comply with the March 11, 1991 order and permanently enjoins him and MC Group from directly or indirectly violating §15(a) of the Exchange Act. The nature of Milken's and MC Group's alleged activities did seem to require registration as a broker-dealer. The alleged transactions included giving advice, participating in negotiations and receiving transaction-based compensation. It is also fair to conclude that the staff's decision was motivated in part by

Milken's violation of the SEC's 1991 order that disciplined Milken for previous violations of the securities laws.

2. Electronic Communication Services/Listing Services.

Finders that use electronic communication services or listing services have been granted no-action assurance. In International Business Exchange Corporation, SEC No-action Letter (December 12, 1986) the SEC granted no-action assurance. IBEC was a business broker in Texas, registered as a real estate broker in the states where it operated. It sold assets of businesses that were going concerns through advertising in national publications. Sometimes the only way to effect the sale was through a business entity, such as a closely held corporation, partnership, etc. This meant that stock or other securities might be involved in the transaction. For its services IBEC would get a commission based on the sales price, computed on the gross asset value. For purposes of computing the commission, all sales are treated as asset sales free and clear of all indebtedness. This letter is described in detail in Section IV.

Until 1985, this kind of a transaction would often be deemed not to involve a security. However, in that year the U. S. Supreme Court, in Landreth Timber Co. v. Landreth, 105 S. Ct. 2297 (1985) held that the sale of a business effected by transferring ownership of 100% of a company's stock constituted a securities transaction with all the protections of the securities laws.

To address the anticipated concerns of the SEC, IBEC stated that it would not do any of a long list of activities which could evoke broker-dealer status, including:

- List corporate stock for sale.
- Advertise corporate stock for sale.
- Have the authority to sell (close) on the seller's behalf.
- Have the authority to purchase on the seller's behalf.
- Handle any funds on account of either buyer or seller.
- Offer stock as an investment.
- Negotiate the terms and conditions of acquisitions to be made for securities issued by the acquiring company.
- Advise the company to be acquired or its shareholders as to the value of the securities to be issued in the acquisition.

After reviewing IBEC's list, the SEC staff said that it would not recommend enforcement action. The staff added that this position was taken because:

- IBEC has a limited role in negotiations between the purchaser and seller.
- The businesses sold were going concerns and not shell corporations.
- Only the assets of the companies were being sold.

- If transactions involved the sale of securities, IBEC would not provide any assistance.
- IBEC did not advise the parties whether to issue securities or assess the value of any securities sold.
- IBEC's compensation did not vary depending on the form of conveyance (e.g. securities rather than assets.
- IBEC had limited involvement in assisting purchasers to obtain financing.

Since listing services are not the focus of this Report, we will include a discussion of other cases in this area.

3. Finders for Issuers.

The scope of activities permitted for finders of issuers has been narrowing. On March 7, 2000, no-action assurance previously granted to Dominion Resources was revoked. Dominion Resources, Inc., SEC No-Action Letter (March 7, 2000). Without discussion, the SEC's 1985 letter had allowed Dominion Resources, Inc., to recommend a bond lawyer to the issuer, recommend an underwriter or a broker-dealer for the distribution or the marketing of a security in the secondary market, and recommend a commercial bank or other financial institution to provide a letter of credit or other credit support for the securities. Dominion Resources, Inc., SEC No-Action Letter (August 24, 1985). If the nature of the financing so required, Dominion Resources was allowed to introduce the issuer to a commercial bank (which may already include the issuer as a customer) to act as the initial purchaser of the securities and as a standby purchaser if the securities cannot be readily marketed by the broker-dealer. Dominion Resources did receive any commissions or other transaction-based compensation in connection with those activities. Dominion Resources did not purchase, sell or solicit purchasers for the securities. The only contact Dominion Resources had with any potential purchaser was the possible introduction of the issuer to a commercial bank standby purchaser.

In addition, Dominion Resources did not bid on any issues of securities nor did it underwrite, trade or hold funds or securities of the issuer. Representatives of Dominion Resources were available, as requested by the issuer, for consultation regarding the terms of the financing, preparation of official statements and other matters leading to the closing. In its capacity as consultant, Dominion participated 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, Dominion Resources provided financial advice consistent with its role as a consultant, but had no authority to represent any of the parties in the negotiations or to bind them to the terms of any agreement. While Dominion Resources 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 Dominion Resources had recommended for its client's adoption, under all circumstances, Dominion acted only on behalf of its client and

subject to the direction of its client and did not act as an independent middleman between the parties.

Representatives of Dominion Resources reviewed the documentation associated with the financing, but the parties to the financing were responsible for the preparation of the documentation and other operational aspects of the financing, such as printing, mailings, delivery of securities or preparation of bond registration.

Dominion Resource charged fees for its consultative and coordinating services that 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. Dominion Resources' fees were not based on successful issuance of securities to the public or affected by secondary trades thereafter. After the closing, Dominion Resources had no further significant involvement with the financing, except that upon occasion, and at the request of the issuer, Dominion Resources would, without compensation and as an accommodation to the issuer from time to time make recommendations about investment of temporarily idle proceeds of an issue or monitor the performance of the issue.

In revoking the 1985 no-action letter, the staff said it had frequently considered the distinction between activities of a broker which require registration and activities of a finder which is not subject to registration. The staff said that because of technological advances and other developments in the securities markets, more and different types of persons have become involved in the provision of securities-related services, requiring greater restrictions on the types of services finders may offer without registering as a broker under the Securities Exchange Act of 1934. Since that time, the staff has denied no-action requests in situations similar to the activities described in the Dominion's August 22, 1985 letter. E.g. John Wirthlin, SEC No-action Letter (Jan. 19, 1999) (no-action request denied where person would solicit investments in real estate limited partnership interests from investors through their accountants and commercial real estate brokers and would receive a fee if any referred investors purchased those securities); Davenport Management, Inc., SEC No-action Letter (Apr. 13, 1993) (broker-dealer registration required where, among other things, business broker receives transaction fees and participates in negotiations); C&W Portfolio Management, Inc., SEC No-action Letter (July 20, 1989) (broker-dealer registration required where company acts as intermediary in negotiations between Treasury dealers until they reach agreement as to the terms of the transaction, and receives a set fee contingent upon consummation of the transaction).

In light of those denials, the staff reconsidered the no-action position taken in the August 22, 1985 letter to Dominion Resources. The staff no longer believes that an entity conducting the activities described in that letter would be exempt from registration as a broker-dealer under §15 of the Exchange Act.

The 2000 Dominion letter is no more explicit in its reconsideration than the 1985 letter was in its grant of no-action relief, but we can assume that any Dominion activities that

were similar to the activities of Wirthlin, Davenport, and C&W were the basis revoking the letter. Since Dominion received transaction-based compensation, provided advice, made recommendations, and was involved in negotiations, the staff felt compelled to revoke the letter for consistency. This letter reflects the staff's position that these activities are significant factors in determining whether the finder is engaged in the activities of a broker-dealer. It also suggests that other letters that came after the 1985 Dominion Resources letter may receive additional scrutiny.

4. Finders for Broker-Dealers.

Finder's activities on behalf of a broker-dealer are not permitted without either broker-dealer registration or registration as a person associated with a broker-dealer. From its perspective, the NASD Regulation, Inc. ("NASDR") (the regulatory arm/subsidiary of the NASD) says it has long been policy to prohibit a member firm from paying finders or referral fees. In Notice to Member 97-11 where the NASDR was requesting public comment on a proposed Code of Conduct Rule 2460 (adopted later after very substantial modifications), the NASDR wrote:

> The NASD believes that it is important to be able to regulate the flow of securities-related compensation from its members to unregistered persons in connection with the solicitation of securities transactions. Therefore, the NASD consistently has taken the position in published interpretations that it is improper for a member or a person associated with a member to make payments of "finders" or referral fees to third parties who introduce or refer prospective brokerage customers to the firm, unless the recipient is registered as a representative of an NASD member firm (See NASD Notice to Members 89-3; NASD Guide to Rule Interpretations (May 1994), p. 108.) This position is based on the definition of "representative" in the NASD rules and the definition of "associated person" in the NASD By-Laws. The NASD interprets these provisions to mean that persons who introduce or refer prospective customers and receive compensation for such activities are engaged in the securities business for the member in the form of solicitation. NASD disciplinary decisions have stated that solicitation is the first step in the consummation of a securities transaction and must be regarded as part of the conduct of business in securities. NASD Regulation ("NASDR") believes that persons who receive compensation from a member for soliciting securities transactions are engaged in the securities business under the control of a member firm and should be subject to NASD qualification and registration requirements.

The NASD's proposed Conduct Rule 2460 raised many other issues in the industry and was never adopted as proposed. However, that has not changed the NASDR's view of these limitations.

From the SEC's perspective, a similar view is illustrated in John R. Wirthlin, SEC No-Action Letter (Jan. 19, 1999). In Wirthlin, the finder proposed to find tax accountants, commercial real estate brokers, and other professionals ("Professionals") whose clients may be

interested in a real estate limited partnership investment structured to achieve tax deferral benefits under Code § 1031. The finder would introduce the Professionals to the registered representatives of a broker-dealer. The finder's involvement would end after setting up and attending a meeting of introduction between the Professionals and the registered representatives. The finder would not have any involvement in the transaction or even contact the potential investor. The finder's compensation would be based on a percentage of the investment and would be paid by the limited partnership. As support for his request, Wirthlin cited the Paul Anka letter along with other letters where the SEC did not require registration. Common to those letters was the fact that the finder was not directly involved in the securities transaction and received transaction-based compensation.

In its analysis, the staff distinguished the activities described by Wirthlin from the activities permitted in the Anka letter because those involved finders for issuers not broker-dealers. The staff said that Wirthlin's proposed activities would be, in effect, soliciting investments in real estate limited partnership interests from investors through their advisors. In addition, Wirthlin would receive transaction-based compensation. Since both activities are characteristic of broker-dealer activities, they require registration. In essence, the finder's proposed activities would be a subset of the normal activities of the broker-dealer's own representatives and both the form and calculation of their compensation would be the same-only paid by different persons. In this case there was no basis for the SEC to draw any meaningful distinction between the finder and the representatives both required registration.

5. Consulting Activities.

Individuals can have a limited role in securities transactions without being deemed to be agents. They can consult on structure, provide valuation reports, render technical advice, provide industry expertise, assist as accountants in the development of forecasts, etc. However, the SEC views transaction-based compensation for such persons as problematic and is suspicious that they really are involved in the entire transaction, including playing a role in obtaining investors. The less involved a business consultant is in the negotiation and structuring of a transaction, the less likely it will be that the staff will require the business consultant to register as a broker-dealer despite the fact that the consultant receives transaction-based compensation. For example, in Russell R. Miller & Co., Inc., SEC No-Action Letter (Aug. 15, 1977), the finder was in the business of locating insurance agencies and evaluating them for acquisition. The finder was paid a fee that was contingent on a subsequent purchase or sale. However, the acquisition of a specific agency was not necessarily structured by the sale of securities and the finder played no role in organizing the actual acquisition. The staff considered the finder to be a consultant "retained to bring to bear its knowledge and expertise to the task of identifying an acquisition prospect" and not as a broker. See also International Business Exchange Corp., supra.

Compensation for consulting services was also the subject of Caplin & Drysdale, Chartered, SEC No-Action Letter (April 8, 1982). Copeland, a registered broker-dealer wanted

to sell annuity plans to public employers in various market areas. In each market, Copeland proposed to hire consultants as independent contractors to provide demographic information about the public employees and financial information about the insurance policies, pension plans, and other financial benefits provided by public employers for public employees. Copeland proposed to pay the consulting firms an annual flat fee and a bonus based on a percentage of the first year annuity's commissions earned from specific annuity plans. The consulting firms would not represent Copeland, provide investment advice, distribute sales material, or participate in negotiations involved in the sales of securities to public employers or their employees. The staff found the proposed actions would not trigger broker-dealer status under the Act.

6. Networking Arrangements.

Networking arrangements first started to be used between a broker-dealer and a financial institution (e.g., certain federal and state chartered banks, savings and loan associations, savings banks, and credit unions) or its service corporation subsidiary have allowed a broker-dealer to provide securities brokerage services on the financial institutions' premises, often using dual financial institution /broker-dealer employees, compensating the financial institution on a percentage lease-revenue basis, and permitting a nominal referral fee to be paid to non-registered financial institution employees. Without no-action relief, it has been the SEC's view that registration would be required of the financial institutions and their employees involved in these arrangements. Registration by financial institutions is extremely difficult given the comprehensive regulatory scheme for financial institutions. Chubb Securities Corporation, SEC No-Action Letter (Nov. 24, 1993).

Under the networking arrangement, the unregistered employees of the financial institutions must be restricted from recommending any security or giving any investment advice and must not be involved in any security transaction. The unregistered employees may receive a one-time, nominal fixed fee for referring financial institution customers to the broker-dealer. Current regulators' thinking is that this nominal fee would amount to no more than one hour of compensation at the employee's current rate. The broker-dealer and the financial institution may share employees that are registered representatives of the broker-dealer, but all compensation related to the sale of securities must come from the broker-dealer only.

The SEC has expanded the arrangements permitted under the Chubb letter to include other types of financial institutions. E.g., The Somerset Group, Inc., SEC No-Action Letter (Dec. 20, 1996); and Mid-Hudson Savings Bank F.S.B., SEC No-Action Letter (May 28, 1993). The staff has also granted no-action requests for arrangements between broker-dealers and insurance companies that were limited in scope to insurance securities and were designed to respond to the difficulties posed by state and federal regulation of those securities. First of America Brokerage Service, Inc., SEC No-Action Letter (Sept. 28, 1995).

The SEC has only recently made clear its intent that networking arrangements such as these may only involve banks, insurance companies, and similarly regulated financial

institutions. Networking and related compensation arrangements are not allowed between broker-dealers and CPA firms without broker-dealer registration. 1st Global, Inc., SEC No-Action Letter (May 7, 2001). The staff reasoned that, unlike financial institutions and insurance companies, there are no similar regulatory protections afforded investors and no regulatory barriers to prevent accounting firms from registering as broker-dealers.

The networking exception to broker-dealer registration was first crafted by a series of SEC no-action letters, but has since been codified into federal securities laws by the Gramm-Leach-Bliley Financial Modernization Act ("GLB Act"). The GLB Act repeals the blanket exemption banks have enjoyed from the definition of "broker" and replaced it with a set of limited exemptions that allow the continuation of some traditional activities performed by banks. Thus, a bank will be considered a "broker" under the Exchange Act and subject to the full panoply of SEC regulation if it engages in the business of effecting transactions in securities for the accounts of others. The GLB amendments reflect a broader political sentiment to more uniformly and closely regulate activities performed by broker-dealers.

7. Compensation Sharing Arrangements.

Registered broker-dealers and their registered representatives are not permitted to share commissions or transaction-based compensation with unregistered persons. This was recently made clear in the context of CPAs and their CPA firms in 1st Global, Inc., SEC No-action Letter (May 7, 2001).

In 1st Global, the company was requesting No-action relief on behalf of its subsidiary 1st Global Capital Corp., a registered broker-dealer. 1st Global Capital Corp. engaged CPAs as registered representatives to sell financial instruments to clients, and paid them commissions. Many of these CPAs have entered into agreements with their CPA firms that require them to account to the firm all revenues generated from firm clients. After firm expenses are paid, the remaining profits are allocated to all the partners under an allocation formula. The other partners, shareholders, or members that will receive a share of the commissions from securities transactions may or may not be registered representatives. 1st Global raised four specific compensation scenarios under which it proposed to pay securities commissions to CPA registered representatives and asked the staff for guidance as to which scenario no-action assurance would be granted. The four scenarios were:

a. 1st Global Capital Corp. would pay commissions to a CPA registered representative without the presence of a partnership agreement mandating the CPA/registered representative to account to the CPA firm for the commissions earned;

b. 1st Global Capital Corp. would pay commissions to a CPA registered representative without the presence of a partnership agreement mandating the CPA to account to the CPA firm for the

commissions earned, but the CPA registered representative would then "voluntarily" turn the commissions over to the CPA firm;

c. 1st Global Capital Corp. would pay commissions to a CPA registered representative subject to an agreement, formal or otherwise, mandating that the CPA account to the CPA firm for the commissions earned; and

d. 1st Global Capital Corp. would pay commissions to another broker-dealer, with whom the CPA registered representative is dually registered, when the CPA firm or its partners own the other broker-dealer.

In its response, the staff stated that scenario (1) was the only scenario that would be granted no-action assurance. The staff stated that registration for individuals that receive transaction-based compensation is required not only for the individual that takes a customers order, but also for any other person in the position to direct or influence the registered representative's securities activities. The staff stated that because the unregistered partners, shareholders, or members of the firm may direct or influence the broker-dealers or registered representative CPAs activities, it may engage in broker-dealer activities. Therefore, without the CPA firm being registered, no commissions may be shared.

The staff stated that this position was consistent with its Freytag, LaForce, Teofan and Falik, SEC No-action Letter (January 1988), where the staff stated it would not recommend an enforcement action if the broker-dealer paid securities commissions to a CPA registered representative. Its no-action position was conditioned on the fact that the CPA would not be subject to any agreement requiring the CPA to turn over the commission for distribution to the partnership. The staff further stated that the registered representative may not forward securities commissions to a CPA firm or other unregistered person under another title or label. Neither may the registered representative make payments for support or services unless they are proportionate to the market cost for those services and do not denote a form of compensation arising from securities transactions. The SEC wrote:

> Under the arrangement described in your letter, an unregistered CPA firm would indirectly receive securities commissions earned by a CPA registered representative, thereby giving it a financial stake in the revenues generated by the registered representative's securities transactions, at the same time that the CPA firm is in a position to influence the registered representative's actions and to direct customers to the registered representative. As discussed above, in the Birchtree line of letters the receipt of transaction related compensation is a key factor in determining whether a person or an entity is acting as a broker-dealer, and that, absent an

> exemption, a person or entity that receives transaction-related compensation in connection with securities activities generally is required to register as a broker-dealer. (See, e.g., Letter re: Birchtree Financial Services, Inc. (Sept. 22, 1998)). The Division is not persuaded that your attempts to factually distinguish the circumstances that underlie the Birchtree letters assuage the core regulatory concerns raised by the receipt of transaction-based compensation.

1st Global is an important letter because it clearly states that if registration is required to sell the security, the sharing or splitting of transaction-based compensation between unregistered persons and either broker-dealers or registered representatives is strictly prohibited. This would include any payments for support or services related to the sale of the security that were not proportionate to the market cost for those services. Payments for support or services may not be used as a form of compensation from securities transactions. The SEC raised the possibility that ordinary distributions of earnings and profits from a registered broker-dealer to an unregistered entity (the CPA firm) could raise compensation-splitting issues depending upon the exercise of the unregistered entity's control over the broker-dealer. The SEC wrote:

> Finally, the Division cannot assure you that, under any circumstances, it would not recommend enforcement action to the Commission under Section 15(a) should 1st Global pay securities commissions to a registered broker-dealer, with which a 1st Global registered representative is dually registered, when that other broker-dealer is owned by an unregistered CPA firm or its partners. This is due to the highly fact-specific nature of any such relationship. Clearly, a registered broker-dealer may receive commissions arising from securities transactions. Under some circumstances, however, the unregistered CPA firm or its partners may exercise such a degree of control over the activities of the broker-dealer or its registered representatives that they themselves engage in broker-dealer activity. In that case, the CPA firm or its partners would have to register as broker-dealers pursuant to Section 15(b), or else, in the case of natural persons, register as associated persons of a broker-dealer. Although you suggest that the unregistered CPA firm or its partners would passively own the registered entity, the question of whether the actions of the CPA firm or its partners constitute broker-dealer activity must turn upon the facts and circumstances of each particular situation.

III. LITIGATION.

So what? In conversations with attorneys this is the most frequently asked question. In essence, what are the consequences of participation by a non-registered broker-dealer in a transaction? This segment of the Report will set forth some of the considerations for counsel in analyzing the consequences of such an involvement.

A. Federal Securities Law.

The starting place in the analysis is with the potential for action by the SEC. If the Division of Enforcement staff at the SEC identifies an unregistered broker-dealer and there has been no fraudulent act committed, the staff is likely to urge registration and if that is forthcoming, close the matter. If there is fraud, it is far more likely that an enforcement action will be commenced.

The SEC Divisions of Enforcement and Market Regulation do not have the staff to conduct the level of surveillance necessary to detect finder activity. An examination of many websites clearly discloses the activity, but there has been no sweep aimed at addressing the issue.

Our review of SEC enforcement cases indicates that most relevant cases name the issuer as well as the broker-dealer in the suit. However, these suits never deal exclusively with using an unregistered broker-dealer. On the contrary, the lawsuits generally involve multiple counts, including violations of the registration provisions for the securities themselves as well as violating the requirement that a broker-dealer be registered. Most important in the determining the results of the lawsuits, however, are the allegations of fraud and misrepresentation.

Often the cases deal with a situation where an individual sets up some sort of scheme, and then sells the idea to unwitting investors. The investor's money is then used to pay off previous investors in a Ponzi scheme or to pay for personal purchases. We found no cases where a finder crossed the line into broker-dealer activity for which the issuer was then punished in the absence of such fraud.

Finders and unregistered broker-dealers have been subject to permanent injunctions for failing to register and then selling securities. When fraud is involved, the SEC pursues disgorgement of the funds as well as civil penalties. These civil penalties are allowed pursuant to the 1990 Civil Remedies Act, the point of which was to punish perpetrators of fraud rather than simply putting them back in the position they would have been in had they not committed the fraudulent act. In one case, an individual who was not found to be a part of the fraudulent operations was still required to pay disgorgement on a theory of unjust enrichment. *See, e.g. SEC v. Cross Financial Services*, 908 F. Supp. 718 (1995).

B. Civil Liability Under Federal Securities Laws.

Unlike many state limited offering or equivalent exemptions, federal private offering exemptions do not condition the use of the exemption on the absence of payments to unregistered broker-dealers or finders. Thus, the issuer does not automatically lose its exemption pursuant to a violation of the securities registration provisions of federal securities laws. Instead, one must look to a three part analysis in determining potential civil liability.

1. Is the person engaging in the activity a broker-dealer?

Section 3(a)(4) of the Exchange Act defines the term "broker."
In the Division of Market Regulation October 1998 *Compliance Guide to the Registration and Regulation of Broker-Dealers* found on the SEC website, there is ambivalence about "finders." This is surprising in light of the history of no-action letters. The guide suggests that the determination of whether one is or is not a broker depends a number of factors, and suggests that "'finders,' or those who find buyers and sellers of securities of business or find investors for registered-broker-dealers and issuers need analyze three issues:

a. Do you participate in important parts of a securities transaction, including solicitation, negotiation or execution of the transaction?

b. 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?

c. Do you handle the securities or funds of others?

If the answer to any of these is "yes" that the reader is cautioned that *you may* need to register as a broker. Those who are uncertain are told that they may want to review SEC interpretations, consult with private counsel, or ask for advice from the SEC. This is far more ambivalent than the no-action letters suggest is appropriate. In those letters, as later in this Report, there is little equivocation. We suggest finders should be specifically instructed that they are required to register unless they meet specific safe harbors created by the SEC in recognition of existing no action letters or acceptance of recommendations from this Report or other commentators.

We not believe that it is necessary to review here the case law relating to broker-dealer status. Rather, we are assuming that the presence of transaction based compensation coupled with any active involvement with the issuer or a broker-dealer, will trigger registration requirements absent an exception, exception or appropriate ruling. We believe that fairly characterizes the Division of Market Regulation's present position.

If a person is required to register as a broker-dealer, and fails to do so while having active participation coupled with transaction based compensation, what are the consequences?

Section 29(b) of the Exchange Act provides that "Every contract made in violation of any provision of this title or any rule or regulation thereunder, and every contract . . . the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of . . . (the Exchange Act) or any rule or regulation thereunder, shall be void: (1) as regards the rights of any persons who, in violation of any such provision, rule or regulation, shall have made or engaged in the performance of any such contract. A maximum three year or one year from date of discovery statute of limitations is applied.

This section suggests that in any civil litigation an unregistered agent acting on behalf of the issuer may be compelled to return their commissions, fees and expenses; and that , the issuer may justifiably refuse to pay a commissions, fees and expenses at closing or recoup them at a later time. It also raises the question of whether the issuer can be compelled to repay these funds to an investor, since the unregistered broker-dealer is acting on behalf of the issuer.

Our research found little guidance on this type of case. Experience tells us that litigation involving unregistered broker-dealers or agents is often quickly settled. Furthermore, a reference to a state regulatory authority will often produce compelling pressure for prompt return of the funds.

C. Civil Liability Under State Securities Law.

Section 402(b)(9) of the Uniform Securities Act as roughly adopted in most states provides generally that the exemption for a limited offering (usually to a small maximum number of persons) is exempt if no commission or similar remuneration is paid for the offer or sale of the securities other than to a registered broker-dealer or agent of the issuer. Some states have added a specific prohibition for payments to "finders." Thus a multi-state transaction done under Sections 4(2) or 3(b) of the 1933 Act will often require use of this state exemption to meet state law requirements. Thus, the ability of either the state or an investor to sue to recover or prevent payment of commissions is clear. Likewise, many states have adopted the Uniform Limited Offering Exemption which applies to offering under Rule 505 of Regulation D, and the ULOE precludes payments in a manner similar to 402(b)(9).

The principal problem for claimants under state law arises in transactions done under Rule 506 of Regulation D. Since Section18(b)(4)(D) of the 1933 preempts much of state law relating to requiring registration of or an exemption for a security, the states lack the power to impose the prohibition of the payment of commissions to unregistered persons as a condition of the exemption.

The states still have a window under Rule 506 however. Generally that rule states that the states may receive a form, get a fee, and continue to police fraud. However, if an issuer fails to comply with the disclosure requirements of Rule 502, the exemption under Rule 506 is lost, and the issuer must then frequently fall back on the Section 402(b)(9) exemption. Hence even in a purported Rule 506 exemption, there is risk of state proceedings.

D. Research.

Commentators have addressed these issues as follows:

1. Analytical Materials.

a. Blue Sky Regulation, Civil Liabilities, 2-9 BSKYRG §9.03 Non-Seller Liability (Matthew Bender, 2001).

According to this chapter:

> In addition to the Uniform Securities Act and states having a comparable provision, Illinois has a statute that makes persons liable strictly by virtue of their relationship to the seller. This statute imposes liability *per se* on the issuer, controlling person, underwriter, dealer, or other person by or on behalf of whom the sale is made. Other underwriters, dealers, or salesman who participated or aided in any way in making the sale may be held liable as may officers, directors, and similar persons of the issuer, controlling person, underwriter, dealer, or other organization by or on whose behalf the sale was made only if such persons participated or aided in making the sale.

However, none of this analysis specifically deals with liability for using an unregistered broker-dealer. Rather, the discussion is couched in general terms. The discussion states that "civil liability for sales of securities in violation of the blue sky law can extend to persons who do not actually sell the securities." No cases cited in these materials deals directly with the issue of the civil liability of an issuer in using an unregistered broker-dealer.

b. Louis Loss and Joel Seligman, Securities Regulation, Civil Liability, 11-B-4, Voidability Provisions (3d, 2001).

Six state statutes contain voidability provisions, all of which specifically give a right of rescission to the buyer. Four states make any sale made in violation of any provision of the Blue Sky statutes voidable. "Arizona limits its voidability provision to the sale of unregistered securities, transaction by unregistered dealers, or specified fraudulent practices;

Florida and Illinois extend rescission to violation of the securities, dealer, associated person, and investment adviser registration provisions."

3. Sample State Cases.

a. *State of West Virginia v. Fairchild; State of West Virginia v. Damron*, 171 W. Va. 137 (1982).

Defendant Damron was convicted of soliciting the sale of securities without being registered as a broker-dealer, selling unregistered securities, and the sale of securities by fraud or deceit. Defendant Fairchild was convicted of aiding and abetting in the sale of unregistered securities, and aiding and abetting by fraud and deceit. Both appealed the conviction; only Damron's appeal is relevant.

The appellant Damron purchased the exclusive rights to market film packages in the state of Kentucky. The franchise agreement was made in Damron's personal capacity, but he later incorporated the business. His plan was to seek investors. He contacted Fairchild, who agreed to provide a list of potential investor's names and show Damron where they lived. Damron solicited funds several times from two brothers. The brothers were told that dividends would be paid within four months, and they would recoup their investment within a year. One of the brothers became suspicious about the apparent lack of progress in the venture after Damron's continued solicitation of funds, so he contact the Securities Division of the State Auditor's office. An investigation began.

The count relevant to this Report is a small part of the overall case. Essentially, on Damron's conviction for being an unregistered broker-dealer, Damron tried to argue as his defense that he was not a broker-dealer, but an issuer. The Court disagreed, holding that the sales solicited by Damron were for stock to be issued by the company Home Movies, Inc., not by Damron in his personal capacity. The Court found this sufficient enough evidence for impartial minds to conclude that Damron was acting as a broker-dealer.

b. *State of Colorado v. Milne*, 690 P.2d 829 (1984).

Defendant acquired an interest in and became president of a small corporation, Valley Loan Association, in 1963. In 1968, he acquired complete ownership. The corporation issued 'investment notes' to purchasers. The revenue from these notes was used to finance consumer purchase money loans. When VLA was suffering financial problems, these proceeds also went to meet interest payments on outstanding notes. Ultimately, VLA declared bankruptcy. Unpaid note holders complained to the district attorney, and criminal charges were filed which charged Milne with failure to register securities, selling securities without a license, fraud by check, and violations of the Colorado Savings and Loan Act. The only guilty verdict was on the licensing charge.

Defendant was convicted of selling securities without a license. He appealed, arguing that he had no obligation to become licensed because he was dealing in exempt securities or exempt transactions. The Court affirmed the conviction, finding that the relevant statute did not expressly exempt sellers of exempted securities from the licensing requirements.

c. *Deets v. Hamilton Management Corp.*, 2 Kan. App. 2d 452 (1978).

Financial Programs, Inc. sold its nationwide capital sales organization to the defendant corporation, Hamilton. The sales agreement authorized Financial employees to sell Hamilton funds, commissions from which were to be paid directly to each agent by Hamilton. Defendant Peggy Dailey accepted employment with Hamilton as part of this agreement. Dailey had been convicted of forgery and had falsified her registration applications to the Kansas Securities Commission and NASD by denying she had any convictions. She had been suspended for selling securities for six months by both agencies because of this. At the time of the transactions at issue in this case, Dailey was not a duly registered agent. The issue was whether the corporation was liable for the acts of Dailey.

The Court held that Hamilton controlled Dailey as an employee. In fact, the court was of the opinion that Hamilton had materially aided Dailey in the fraudulent transactions by supplying her with forms and brochures. This made it appear to the plaintiff that Dailey was authorized to offer the special 'deal' that was a part of her fraud. The court found that 'there is substantial competent evidence to support the trial court's finding as to the defendant corporation's liability."

d. *Bramblewood Investors, Ltd. v. C&G Associates*, 262 N.J. Super. 96 (1992).

Plaintiff Bramblewood sought summary judgment for the amount allegedly owed by the defendant. Bramblewood offered limited partnerships in an apartment complex in High Point, North Carolina. C&G executed promissory notes for three partnership interests in 1985. In 1989, C&G allegedly defaulted on the loans. Among other claims, C&G argued that it had the right to rescind because United Capital Securities, the general partner of Bramblewood, failed to register as an agent under the New Jersey Uniform Securities Law.

The Court found that all of C&G's counterclaims were time- barred. Even if the allegations surrounding the failure to register as an agent were true and not time-barred, the court pointed out that the facts alleged did not have any nexus to the defendant's claims. Defendants refer to two individuals who were not defendants in this case and their contact in New Jersey with a United Capital Representative. The court pointed out that, while those two individuals may be entitled to rescission, the defendants in this case were not. They had no claim under the statute for sales by an unregistered broker because they did not purchase from one.

2. Federal Case Law.

a. *SEC v. Alliance Leasing Corporation*, 2000 U.S. Dist. LEXIS 5227(2000).

This case involved the sale of equipment leases. The leases were considered investment contracts, and securities within the definition of the Securities Act of 1934. The significant parties to the suit were the leasing corporation, the entity that acted as broker-dealer (Prime Atlantic), and the principal shareholders of the leasing company (the Brownes).

Alliance Leasing Corporation was based in San Diego. It recruited over 1,500 individuals throughout the country to invest in its venture. The idea was to purchase commercial office and kitchen equipment with investor funds, and then lease that equipment out to third-party lessees. The lease payments were to be paid out to investors monthly for two years, with a balloon payment at the end of the two years. Investors were told that the investment was low risk and that it would garner a 14% per year return.

The SEC brought an action against Alliance, claiming that the package being sold were investment contracts that were unlicensed securities. The parties were also charged with misrepresenting information critical to an investor's informed decision to invest. Prime Atlantic ("Prime") was charged with selling securities as an unregistered broker-dealer, selling unregistered securities, and fraud in failing to report that it received a 30% commission. The case was disposed of on a motion for summary judgment in favor of the SEC.

The charge for violating section 15(a)(1) of the Exchange Act was targeted solely at Prime and its owners. The court granted summary judgment against Prime, as there was no dispute of material fact that the company was acting as a broker with regard to the investment contracts. All other charges were directed at all defendants, and summary judgment was also granted on each of the other claims.

The owners of Alliance were repeat offenders who had no remorse for their activities. The court therefore issued a permanent injunction against them. However, it did not feel that Prime deserved such harsh penalties. There were no securities violations in its past. Also, Prime had relied on advice of counsel, who told Prime that the contracts were not securities. Therefore, the court found that there was very little intent on the part of Prime to violate securities laws, with the exception of the lack of disclosure with regard to commissions.

All parties were ordered to pay disgorgement plus interest, as well as the maximum civil penalty. It is hard to isolate exactly how much of the costs for Prime had to do with the fact that it was unregistered. There was no discussion of holding the issuer responsible for using an unlicensed broker-dealer.

b. *SEC v. Interlink Data Network*, 1993 U.S. Dist. LEXIS 20163 (1993).

InterLink solicited more than $21 million from over 700 investors across the country. 908 F. Supp. at 720. They failed to comply with securities registration requirements, misused investor funds, and operated a Ponzi scheme. *Id*. The SEC filed a complaint for temporary and permanent injunctions. The SEC commenced an action against the defendants, complaining that they were operating a nationwide fraudulent scheme. The defendants included InterLink Data Network and its two partnerships, InterLink Fiber Optic Partners, L.P. and InterLink Video Phone Partners, L.P. (the "defendant issuers"). Michael Gartner, a principal officer of InterLink, was also named in his individual capacity. The SEC also alleged that the defendants were conducting an unregistered brokerage operation. The SEC alleged that they had set up a boiler-room operation and were acting as unregistered broker-dealers.

The subject of the InterLink investment scheme was telecommunications. The idea was marketed as a concept to develop "private, fully integrated telecommunication networks and video phone systems." 1993 U.S. Dist. LEXIS 20163 at *4. The sales pitch was that investor funds would be used to lay fiber-optic cable in Los Angeles, as well as to manufacture video telephones. Neither of these activities actually occurred. Rather, the funds were used to pay previous investors. Subsequent offerings promised much of the same – that the money would be used to invest in telecommunications technology, and that the returns would be anywhere from twelve to eighteen per cent.

There were no registration statements filed for the securities. Defendants attempted to rely on exemptions from registration, including Regulation D. However, defendants were not eligible for these exemptions because the offerings were not limited to accredited investors (in fact, defendants knowingly sold to unaccredited investors), and they had engaged in general solicitations for sales.

There were several material misrepresentations made by the defendants in selling the securities. Potential investors were told that InterLink possessed several patents for the video phone technology though it actually owned none of these patents. Potential investors were also told that fiber optic lines were being run in Los Angeles, that InterLink securities were publicly traded on AMEX or NASDAQ, and they were given unsupported guarantees of investment returns, among other misrepresentations.

Defendants arranged with Portfolio Asset Management ("PAM"), a registered broker-dealer, to provide a shield for the activities of more than 80 unregistered salespersons who were working the phones in the two boiler-rooms the defendants had set up. However, there was little distinction between PAM and Interlink. Interlink paid PAM's overhead, all sales documents were kept by InterLink, Gartner hired the sales force used to sell Interlink securities, and investor checks were sent directly to InterLink and not to PAM.

The court granted the SEC's motion for summary judgment on all issues. Gartner failed to file an answer, and he refused to respond to discovery requests, asserting his Fifth Amendment privilege against self-incrimination. Defendant issuers did not respond to discovery requests, stating that there was no one left at the companies to respond except Gartner, who again asserted his Fifth Amendment privilege. The Court found that the defendant issuers and Gartner had engaged in selling unregistered securities, they had engaged in fraud and misrepresentation in the course of those sales, they had used investor funds improperly, and they sold securities without being registered broker-dealers.

The court found that the facts of this case were particularly deplorable. Hundreds of individuals, trusts, and corporations invested funds in InterLink. Many of the investors were retirees living on fixed incomes. The defendants were aware of the impropriety of their activities, and they showed little remorse for their transgressions.

The court granted several forms of relief. First, it granted a permanent injunction, stating that the "defendants' violations were intentional and calculated, and occurred repeatedly for years." All defendants were permanently enjoined from future violations of the Securities and Exchange Act at issue in this case, namely sections 17(a) and 10(b) of the Securities Act and section 15(a) and Rule 10b-5 of the Exchange Act.

The court also ordered disgorgement of the illegally raised monies, amounting to just over $12 million. Defendants were held jointly and severally liable for the return of all funds raised. Because the violations were so blatant, the court awarded prejudgment interest as well.

Finally, the court also imposed civil penalties against the defendant issuers. Against a non-natural person, the court could impose a fine of $500,000 or the gross amount of the monetary gain. In this instance, the court fined the defendant issuers another $12,285,035, the total amount of the gain. The SEC withdrew its request to fine Gartner, but the Court noted that it would be warranted in doing so under the facts of the case.

IV. THE CURRENT LAW ON FINDERS IN MERGER & ACQUISITION TRANSACTIONS.

A. Introduction.

Attorneys are often confronted with the issue of whether and under what circumstances transaction-based compensation can be paid to an intermediary - termed a finder, business broker, or investment banker - that is not registered as a broker-dealer. For convenience these individuals or entities will be referred to simply as "finders" in this outline.

No law or rule clearly sets out the parameters of permissible conduct for a finder, so we must turn to SEC No-Action letters for guidance. There have been very few SEC No-

Action letters regarding intermediaries in mergers and acquisitions.[6] Many of the SEC letters consist only of general statements of law and expressly refrain from taking No-Action positions. This outline first discusses the SEC's initial position on finders in mergers and acquisitions and then a 1986 No-Action letter where the SEC softened its position on finders that received transaction based compensation in *International Business Exchange Corporation*, SEC No-Action Letter (December 12, 1986). Finally we review the SEC's position on finders in mergers and acquisitions since the 1986 No-Action letter.

In the 1970s and early 1980s, the SEC was active in denying relief to individuals or entities seeking blessing on their finder's activities which would require them to register as broker-dealers under Section 15(a) of the Securities Exchange Act of 1934 (the "Act"). The SEC frequently stated:

> Registration pursuant to Section 15 of the Act of persons engaged in merger and acquisition activity has in the past often been deemed necessary where these activities involve either a distribution or an exchange of securities. Individuals who do nothing more than bring merger or acquisition-minded persons or entities together and do not participate in negotiations or settlements probably do not fit the definition of a "broker" or a "dealer" and would not be required to register. On the other hand, persons who play an integral role in negotiating and effecting mergers or acquisitions, particularly those persons who receive a commission for their efforts based on the cost of the exchange of securities, are required to register with the Commission.

Gary L. Pleger, Esq., SEC No-Action Letter (October 11, 1977); *Ruth Quigley*, SEC No-Action Letter (July 14, 1973); *IMF Corp.*, SEC No-Action Letter (May 15, 1978). There are, however, some SEC No-Action letters that review factual situations where a finder needs to register as a broker-dealer. Since each situation is fact dependent, the SEC bases its decision to grant No-Action relief on many factors, but certain factors are highlighted in many of the decisions. The summaries of the relevant letters that follow emphasize just how fact dependent each situation is.

1. **Transaction Based Compensation**.

Transaction-based compensation triggered the requirement for broker-dealer registration in *Mike Bantuveris*, SEC No-Action Letter (October 23, 1975), where the company wished to offer a consulting service in which it would identify companies as possible acquisition

[6] John Polanin, Jr., *The "Finder's" Exception from Federal Broker-Dealer Registration*, 40 Cath. U. L. Rev. 787, 816 (1991) (hereinafter "Polanin article").

candidates and assist its clients in negotiating toward a final agreement. The company proposed to base its fees, in part, on the total value of consideration received by the sellers or paid by the buyers. On these facts, the staff of the Division of Market Regulation indicated that the company would be required to register as a broker-dealer. The staff noted that its opinion was "based primarily on the fact that the consulting firm would . . . receive fees for its services that would be proportional to the money or property obtained by its clients and would be contingent upon such transactions in securities." *See also John M. McGivney Securities, Inc*., SEC No-Action Letter (May 20, 1985).

In *Biscotti and Company*, SEC No-Action Letter (November 28, 1985), Biscotti and Company sought No-Action for an entity it wished to establish for the purpose of providing financial planning and related services. These services would include the compilation of financial data for clients, the analysis of clients' current and projected requirements in various areas (including cash flow, insurance needs, and prospective tax liability), and the preparation of a written financial plan making various recommendations. In many cases, the financial plan would include recommendations for the purchase of various investments, such as common stocks, bonds, mutual funds and limited partnerships. The entity planned to register as an investment advisor. Biscotti and Company expected that many of the clients would seek assistance in implementing their recommendations, including acquiring investments. The entity would then receive a finder's fee for putting the clients in touch with others that could help them. The SEC letter stated that it would recommend No-Action based on the stated facts, in particular the fact that neither the financial planning entity nor its principals directly, or indirectly, retain any portion of the implementation fees generated.

2. Negotiation or Advice.

Generally, if an entity acts as a finder and participates in negotiations between the buyer and seller, the SEC will require registration as a broker-dealer. In *Fulham & Co., Inc.*, SEC No-Action Letter (December 20, 1972), the private investment banking firm consulted on mergers and assets sales, reviewed financial reports, and advised management on financial decisions. The firm participated in negotiations and received a commission based on the sale. Broker-dealer registration was required based on the participation in negotiations. The other side of this spectrum was reflected in *the Corporate Forum, Inc.*, SEC No-Action Letter (December 10, 1972), where the staff granted relief to a financial consultant who would locate merger and acquisition candidates for its clients, but it would not participate in negotiations.

In *Russell R. Miller & Co., Inc*., SEC No-Action Letter (August 15, 1977), the finder was in the business of locating insurance agencies and evaluating them for acquisition. The finder was paid a fee that was contingent on a subsequent purchase or sale. However, the acquisition of a specific agency was not necessarily structured by the sale of securities and the finder played no role in organizing the actual acquisition. The staff considered the finder to be a consultant "retained to bring to bear its knowledge and expertise to the task of identifying an acquisition prospect" and not as a broker.

No-Action relief was denied in *May-Pac Management Co.*, SEC No-Action Letter (December 20, 1976). There the company specialized in mergers and acquisitions, and proposed to seek out potential sellers of corporations, bring them together with potential buyers, and work toward closing the transaction. The company acknowledged that, in most cases, it would participate in whatever negotiations were necessary to close the deal and advise its client as to the quality of any offer received. On the basis of these activities, the SEC concluded that the company would be required to register as a broker-dealer. The staff found that the proposed activities were more than merely bringing together the parties to transactions involving the purchase or sale of securities. The firm proposed to negotiate agreements, engage in other activities to consummate the transactions, and to receive fees for its services that would be proportional to the money or property obtained by its clients and would be contingent upon such transactions in securities. The SEC emphasized that "persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities generally are deemed to be either a broker or a dealer, depending upon their particular activities, and are required to register with the Commission." [7]

In the realm of real estate transactions, the SEC granted No-Action relief to Victoria Bancroft, a licensed real estate broker, who established lists of clients who might be interested in acquiring financial institutions that are for sale. *Victoria Bancroft*, SEC No-Action Letter (August 9, 1987). The *Bancroft* letter describes her activities as being "limited merely to the introduction of parties." She did not participate in the establishment of the purchase price or any other negotiations between the parties. The parties created all materials related to either the sale or purchase of the financial institutions without Bancroft's involvement. She didn't even facilitate exchange of the information. At most, she described to the potential purchaser the type of institution, the asking price, and the general location. If the potential person were interviewed, Bancroft would arrange a meeting with the seller or seller's representative. Either the buyer or seller would compensate Bancroft by a flat fee or a percentage of the purchase price. The compensation was considered to be a referral fee or finder's fee.

In granting No-Action relief, the staff indicated that (1) Bancroft had a limited role in negotiations between the purchaser and seller; (2) the businesses represented by Bancroft were going concerns and not shell corporations; (3) transactions affected by means of securities will convey all of a business's equity securities to a single purchaser or group of purchasers formed without the assistance of Bancroft; (4) Bancroft did not advise the two parties whether to issue securities or assess the value of any securities sold; and (5) Bancroft did not assist purchasers to obtain financing. The staff further stated that Bancroft *would* be subject to the anti-fraud provisions of the federal securities law to transactions in which securities are used to transfer ownership of a business.

[7] *See also Samuel Black*, SEC No-Action Letter (December 20, 1976) (stating that no registration is required where a finder's participation in negotiations is limited to performing the "ministerial function of facilitating the exchange of documents or information").

3. Solicitations.

In *Thomas R. Vorbeck,* SEC No-Action Letter (March 24, 1974), the company proposed to offer a two-part securities service package to its employees in order to cure what it viewed as deficiencies in its employee stock purchase plan. Under the plan, employees could elect to reduce their commission expenses by assigning the stock to the employer, and/or to increase their profits by authorizing the employer to sell short designated shares of stock once each quarter. On the basis of these facts, the SEC indicated that the company would be required to register as a broker-dealer under Section 15(a). As the SEC explained, the proposed activities "would appear to bring [the company] within the definition of a broker since it is reasonable to presume that [among other things] . . . the plan would entail some form of solicitation of business on your behalf." Somehow in the submission the potential for loss was also overlooked.

In *Club Panorama*, SEC No-Action Letter (February 27, 1975), an individual acted as a finder in seeking out broker-dealer firms. The broker-dealer firms would then find buyers for limited partnership interests in Club Panorama, for whom the finder worked. He would not solicit to purchase or offer for purchase any limited partnership interest himself. Also, the selling agreements would be between the broker-dealers and the general partners of the limited partnership and the finder would not receive any commission-based funds. Under those facts, the SEC did not see the need for the finder to be registered as a broker-dealer.

4. Prior Experience and Violations.

One other factor that has been given weight by the SEC in its broker-dealer analysis is whether the finder has previously been involved in sales of securities and/or disciplined for violations of the securities laws. As a general matter, previous involvement of this nature seems to increase the likelihood that the finder will be required to register as a broker-dealer.[8] In *Price*, the finder was retained to locate brokers-dealers as potential underwriters or participants in private offerings. The finder was to have no involvement in actual selling efforts, and his fee was not based on commission tied to sales. Although the usual indications of broker-dealer status seemed to be lacking from this case, the SEC indicated that the finder would be required to register as a broker-dealer. While the SEC did not directly attribute this opinion to the finder's prior securities activities and disciplinary history, the letter began by describing at length the fact that the finder had previously engaged in the sale of securities and that he had recently been disciplined for violations of the Act. Since nothing in the nature of the finder's proposed activities would otherwise seem to have necessitated registration as a broker-dealer, it is fair to conclude that the SEC's decision was motivated by the finder's previous securities activities and problems.

5. Advising.

The SEC's interpretative letter of *Jack Northrup Associates*, SEC No-Action Letter (February 9, 1972), presented a situation where a firm in the consulting business proposed to act

[8] *See, e.g.*, *Rodney B. Price and Sharod & Assocs.*, SEC No-Action Letter (November 7, 1982).

as a finder for mergers, acquisitions and other venture capital situations. As a finder, the firm proposed through personal contact, referrals, direct mail and the like, to transmit data to likely prospects concerning companies which had an interest in being acquired, or in acquiring other interests. The firm's role in a transaction would normally stop short of becoming involved in negotiations. However, the firm proposed to continue to be involved in the communications between the parties, and would continue to advise one or the other parties in circumstances in which it had previously advised them on their general financial plans. On those facts, the SEC declined to provide a No-Action letter.

In *F. Willard Griffith, II*, SEC No-Action Letter (January 8, 1975), the finder proposed to introduce individuals, corporations and other business entities to others for the purpose of enabling such parties to negotiate mergers, consolidations, other forms of business acquisitions and the purchase and sale of business assets. Prospective "buyers" who would subscribe to the finder's service were asked to submit a written description of the types of business entities or assets they were seeking, and the manner and terms upon which they propose to purchase or acquire such entities or assets. Prospective "sellers" who subscribed to the finder's service were asked to submit a written statement describing the natures of their businesses, their capital structures, their financial conditions and past performances, and the manner and terms upon which they wished to raise additional capital or be acquired. The finder also proposed to introduce persons and business entities who have indicated a desire to meet each other for the purpose of directly negotiating lawful transactions in particular securities. The SEC did not make a ruling on whether the finder needed to register as a broker-dealer, but rather concluded that the finder needed to register as a investment advisor under the Investment Advisers Act of 1940. The SEC stated that "the proposed service of disseminating information submitted by subscribing 'buyers' and 'sellers' by means of a publication would appear to involve issuing or promulgating analyses or reports concerning securities within the meaning of the Act."

B. SEC's Change in Position.

The SEC changed its position on transaction-based compensation in 1986 when it issued a No-Action letter to International Business Exchange Corporation. *International Business Exchange Corporation*, SEC No-Action Letter (December 12, 1986) ("IBEC"). IBEC was a business broker in Texas and registered as a real estate broker in the states where it operated. It sold assets of businesses that were going concerns through advertising in national publications. Sometimes the only way to effect the sale was through a business entity, such as a closely held corporation, partnership, etc. This meant that stock or other securities might be involved in the transaction. For its services IBEC would get a commission based on the sales price, computed on the gross asset value. For purposes of computing the commission, all sales are treated as asset sales, free and clear of all indebtedness.

IBEC did provide information supplied by the seller to the buyer. IBEC also informed the buyer that IBEC neither verified the seller's information nor made any representations or warranties about the seller's information. At the request of buyers, IBEC would

provide a list of potential lenders that have expressed an interest in extending credit, but IBEC did not assist buyers in obtaining financing. IBEC's only involvement in the parties' negotiations was transmitting documents between the parties.

In addition, IBEC advised the seller and the buyer that it was not a NASD registered broker-dealer, and it would not offer a security under the law for sale. Further, IBEC specifically stated in its listing agreement that the sale of a security constituted default in its agreement. Buyers were advised and encouraged to make a thorough investigation of any company, including visiting and inspecting the property offered for sale. Both parties were advised to seek independent counsel before entering into any binding agreement.

Until 1985, this kind of a transaction would often be deemed not to involve a security. However, in that year the U.S. Supreme Court, in *Landreth Timber Co. v. Landreth*, 105 S. Ct. 2297 (1985) held that the sale of a business effected by transferring ownership of 100% of a company's stock constituted a securities transaction with all the protections of the securities laws.

To address the anticipated concerns of the SEC, IBEC stated that it would not do any of the following:

- List corporate stock for sale.
- Advertise corporate stock for sale.
- Have the authority to sell (close) on the seller's behalf.
- Have the authority to purchase on the seller's behalf.
- Handle any funds on account of either buyer or seller.
- Offer stock as an investment.
- Negotiate the terms and conditions of acquisitions to be made for securities issued by the acquiring company.
- Advise the company to be acquired or its shareholders as to the value of the securities to be issued in the acquisition.

After reviewing IBEC's list, the SEC staff said that it would not recommend enforcement action. The staff added that this position was taken because:

- IBEC has a limited role in negotiations between the purchaser and seller.
- The businesses sold were going concerns and not shell corporations.
- Only the assets of the companies were being offered.
- If transactions involved the sale of securities, IBEC would not provide any assistance.
- IBEC did not advise the parties whether to issue securities or assess the value of any securities sold.
- IBEC's compensation did not vary depending on the form of conveyance (*e.g.* securities rather than assets).
- IBEC had limited involvement in assisting purchasers to obtain financing.

The *IBEC* letter has been cited by parties seeking No-Action relief as standing for the proposition that individuals that do nothing more than find issuers of securities, and who do not participate in negotiating the sale of securities nor share in the profits realized, are not brokers or dealers and are not required to register as such.[9]

C. SEC's Current Position.

In the Polanin article, the author [10] states that only two No-Action letters have been issued on the topic of transaction based compensation for finders who bring buyers and sellers of businesses together.[11] The two letters cited are *IBEC* and *Victoria Bancroft* (both discussed above). The article hypothesizes that "[t]he absence of any additional letters since those were issued may indicate that the staff would prefer counsel to be guided by the statements in those letters rather than request individual No-Action positions."[12] What the author is suggesting could very well be the reason why there has not been a No-Action letter since then on this specific topic. In *IBEC*, the SEC set out a definitive list of factors to be considered in determining whether someone acting as a finder or business broker needed to be registered as a broker-dealer. *Id.*

The SEC declined to make a decision on whether an accountant, that advises a client on how to structure the sale of its business, needs to be registered as a broker-dealer under Section 15(a). *Magnuson, McHugh & Company, P.A.*, SEC No-Action Letter (November 13, 1989). There, the SEC stated that if the accountant advised any other person on the value of the stock or the advisability of investing in the stock, then that person might have to be registered as a broker-dealer. The SEC enclosed the *IBEC* No-Action letter so the person could conduct its own analysis.

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[9] *L and N Land Corporation*, SEC No-Action Letter (July 7, 1987) (receiving No-Action relief to offer and sell guaranty letters of credit as guaranties of the principal and interest on tax-exempt municipal obligations); *Mid-Atlantic Investment Network*, SEC No-Action Letter (May 18, 1993) (receiving No-Action relief for a not-for-profit organization to identify sources for funds to be invested in small businesses); *John R. Wirthlin*, SEC No-Action Letter (January 9, 1999) (denied No-Action relief for acting as a finder for a broker-dealer).

[10] John Polanin Jr. held the SEC position of Branch Chief, Office of Chief Counsel, Division of Market Regulation.

[11] In a No-Action letter, the SEC cited the Polanin article as being a comprehensive discussion on finders. *Hamilton & Company*, SEC No-Action Letter (April 21, 1995).

[12] Polanin article, at 819.

D. Significant Cases Since *IBEC*.

The SEC has left open whether a commission-like fee arrangement, standing alone, will always constitute grounds for registration as a broker-dealer. *Paul Anka*, SEC No-Action Letter (July 24, 1991), provides the unusual case where a commission-like fee has been allowed to stand (for the moment). The staff's favorable position would appear to be attributable to the uniquely limited duties of the finder involved in the case. In *Anka*, the Ottawa Senators Hockey Club retained entertainer Paul Anka to act as a finder for purchasers of limited partnership units issued by the Senators. Anka agreed to furnish the Senators with the names and telephone numbers of persons in the United States and Canada whom he believed might be interested in purchasing the limited partnership units. Anka would neither personally contact these persons nor make any recommendations to them regarding investments in the Senators. It is noteworthy that in Mr. Anka's original proposal letter to the SEC he would have made the initial contact with prospective investors. In exchange for his services, Anka would be paid a finder's fee equal to 10 percent of any sales traceable to his efforts. Important factors identified in the *Anka* letter include:

- Mr. Anka had a bona fide, pre-existing business or personal relationship with these prospective investors.
- He reasonably believed those investors to be accredited.
- He would not advertise, endorse, or solicit investors.
- He would have no personal contact with prospective investors.
- Only officers and directors of the Senators would contact the potential investors.
- Compensation paid to the Senators' officers and directors would comply with SEC Rule 3a-1 (governs compensating issuer's agents).
- He would not provide financing for any investors.
- He would not advise on valuation.
- He would not perform due diligence on the Senators' offering.
- He had never been a broker-dealer or registered representative of a broker-dealer.

The SEC indicated that it would not recommend enforcement action if Anka engaged in the proposed activities without registering as a broker-dealer.

A significant No-Action letter involving solicitation is *Dana Investment Advisors, Inc.*, SEC No-Action Letter (October 12, 1994). In that letter, Dana Investment Advisors, Incorporated ("Dana"), a registered investment adviser, intended to organize a private investment fund (the "Partnership") that would be structured as a limited partnership under Wisconsin law. Dana was to be the Fund's general partner and investment adviser. Limited partnership interests ("Units") in the Partnership were to be offered only to private hospitals that were members of the Washington State Hospital Association, a not-for-profit corporation (the "Association") and certain qualifying affiliates (the hospitals and their affiliates are collectively referred to as the "Qualifying Hospitals").

The Association, through its wholly-owned subsidiary WHS, proposed to enter into an agreement (the "Agreement") with the Partnership under which WHS would disseminate information about the Partnership's existence to members of the Association eligible to invest in the Partnership, and introduce Dana to such members. WHS would:

1. Provide Dana with certain public financial information about the Qualifying Hospitals.
2. Request that Qualifying Hospitals fill out questionnaires eliciting basic financial information.
3. Provide the Partnership with the names and addresses of Qualifying Hospitals.
4. Personally introduce the appropriate officer of each Qualifying Hospital to representatives of Dana.
5. Disseminate to Qualifying Hospitals general information about the existence of the Partnership through direct mailings, announcements in periodic newsletters, and brochures.
6. Permit representatives of Dana, who will be offering and selling Units, to rent a booth at the exhibit hall at the Association's annual meeting to distribute the Partnership's offering memorandum and sales literature, and to discuss the Partnership with Qualifying Hospitals.

The Partnership would pay WHS a fee (the "Fee") of up to .07% per annum of Partnership assets for WHS' services. Based on the facts provided, the SEC would not recommend enforcement action under Section 15(a) if WHS or its employees engaged in the activities set forth without registering as broker-dealers.

On March 7, 2000, No-Action assurance previously granted to Dominion Resources was revoked. *Dominion Resources, Inc.*, SEC No-Action Letter (March 7, 2000). The facts in *Dominion* did not involve mergers and acquisitions, but the discussion in the case is useful in trying to determine the SEC's current view on finders in general. Without discussion, the SEC's 1985 letter had allowed Dominion Resources, Inc. to recommend a bond lawyer to the issuer, recommend an underwriter or a broker-dealer for the distribution or the marketing of a security in the secondary market, and recommend a commercial bank or other financial institution to provide a letter of credit or other credit support for the securities. *Dominion Resources, Inc.*, SEC No-Action Letter (August 24, 1985). If the nature of the financing so required, Dominion Resources was allowed to introduce the issuer to a commercial bank (which may already include the issuer as a customer) to act as the initial purchaser of the securities and as a standby purchaser, if the securities cannot be readily marketed by the broker-dealer. Dominion Resources did not receive any commissions or other transaction-based compensation in connection with those activities. Dominion Resources did not purchase, sell or solicit purchasers for the securities. The only contact Dominion Resources had with any potential purchaser was the possible introduction of the issuer to a commercial bank standby purchaser.

In addition, Dominion Resources did not bid on any issues of securities nor did it underwrite, trade or hold funds or securities of the issuer. Representatives of Dominion Resources were available, as requested by the issuer, for consultation regarding the terms of the financing, preparation of official statements and other matters leading to the closing. In its capacity as consultant, Dominion Resources participated 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, Dominion Resources provided financial advice consistent with its role as a consultant, but had no authority to represent any of the parties in the negotiations or to bind them to the terms of any agreement. While Dominion Resources 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 Dominion Resources had recommended for its client's adoption, Dominion Resources, under all circumstances, acted only on behalf of its client and subject to the direction of its client and did not act as an independent middleman between the parties.

Representatives of Dominion Resources reviewed the documentation associated with the financing, but the parties to the financing were responsible for the preparation of the documentation and other operational aspects of the financing, such as printing, mailings, delivery of securities, or preparation of bond registration.

Dominion Resource charged fees for its consultative and coordinating services that 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. Dominion Resources' fees were not based on successful issuance of securities to the public or affected by secondary trades thereafter. After the closing, Dominion Resources had no further significant involvement with the financing, except that upon occasion, and at the request of the issuer, Dominion Resources would, without compensation and as an accommodation to the issuer, from time to time make recommendations about investment of temporarily idle proceeds of an issue or monitor the performance of the issue.

In revoking the 1985 No-Action letter, the staff said it had frequently considered the distinction between activities of a broker which require registration and activities of a finder which is not subject to registration. The staff said that *because of technological advances* and other developments in the securities markets, *more and different types of persons* have become involved in the provision of securities-related services, requiring greater restrictions on the types of services finders may offer without registering as a broker under the Securities Exchange Act of 1934. Since that time, the staff has denied No-Action requests in situations similar to the activities described in the Dominion's August 22, 1985 letter.[13]

[13] *E.g.*, *John Wirthlin,* SEC No-Action Letter (Jan. 19, 1999) (No-Action request denied where person would solicit investments in real estate limited partnership interests from investors through their accountants and commercial real estate brokers and would receive a fee if any referred investors purchased those securities); *Davenport Management, Inc.,* SEC No-Action Letter (Apr. 13, 1993) (broker-dealer registration required where, among other things, business broker receives transaction fees and participates in negotiations); *C&W Portfolio Management, Inc.,* SEC No-Action

In light of those denials, the staff reconsidered the No-Action position taken in the August 22, 1985 letter to Dominion Resources. The staff no longer believes that an entity conducting the activities described in that letter would be exempt from registration as a broker-dealer under §15 of the Exchange Act.

Conclusion

IBEC still seems to be an accurate representation of the SEC's view on what a finder can do without having to register as a broker-dealer. The SEC has not stated that the factors set out in that letter should not be relied upon. In fact, the SEC used the letter as a guide to what is permissible. *Magnuson, McHugh & Company, P.A.*, SEC No-Action Letter (November 13, 1989).

It appears that the law is sufficiently settled in this area that the SEC should consider promulgation of a rule, or at the very least an interpretive release, adopting IBEC and giving further guidance to those finders, issuers, and counsel who struggle with the extent of permissible compensation and the consequences for paying it.

V. INTRASTATE BROKER-DEALER EXCEPTION.

We believe that it is appropriate to consider adoption of a broaden intrastate broker-dealer exemption for firms engaging in limited activities in a state and registered to engage in those activities.

Justice Brandeis suggested that the states provide a workshop for development of the law. State blue sky laws differ rather dramatically from the Exchange Act in two respects. The first is minor. As noted earlier, Michigan has crafted an exemption from broker-dealer registration for finders who engage in conduct specifically limited by statute. A few other states will permit a one-time registration with very reduced obligations in conjunction with a specific state offering.

The second exception is a great deal broader. The SEC does not directly register agents of an issuer, other than by requiring their registration as a broker-dealers. The federal safe harbor carve-out in Exchange Act Rule 3a4-1 precludes payment of transaction based compensation to employees of an issuer. However, the states permit registration of agents of an issuer who are paid such compensation. We believe that such agents are used not only in intrastate offerings, but in offerings filed with the SEC in some limited circumstances.

Agents of the issuer customarily fit two different situations. Some issuers, typically non-profit entities, conduct on-going offerings and several states require renewal of

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Letter (July 20, 1989) (broker-dealer registration required where company acts as intermediary in negotiations between Treasury dealers until they reach agreement as to the terms of the transaction, and receives a set fee contingent upon consummation of the transaction).

agent registration on an on-going basis. These agents normally meet the federal 3a4-1 safe harbor.

In the second instance, for-profit issuers may hire sales representatives who receive a commission. These individuals register with the state through the issuer. They may be required to take examinations (typically a Series 63 but in some instances a Series 6 or 7), complete the U-4, submit fingerprint cards and consents to service of process, and receive a registration order for the earlier of the termination of the offering or one year. Customarily the states will limit an individual to between one to three offerings before registration or affiliation with a broker-dealer is required.

Use of the concept of agents of an issuer and the intrastate finder should not be discouraged. Historically there have been almost no problems with these individual agents, so experience does not suggest that more restrictive action is warranted. We believe that a specific carve-out for intra-state registrations and limited use of registered agents of an issuer is warranted. We further believe that such individuals should not be required to be licensed with the NASD unless a specific category for their registration is developed. The states would then be free to adopt less restrictive requirements for finders when they deemed to do so.

VI. ENCOURAGING REGISTRATION.

There is a major conflict between the objectives of bringing persons into compliance and punishing them for past conduct when they are being encouraged to come to the regulator and register. In the broker-dealer arena, there is a significant division of approach. Some states take the view that it is best to get a firm registered, and that asking about prior conduct is counter-productive to getting maximum compliance. Others take the view that improper conduct should always be punished and that in order to be allowed to enter the "legitimate" side of the business one be scourged to expunge prior sins. This latter approach is normally done through an order and fine, though in some instances the prior conduct may be sufficient to prevent registration.

The arguments for encouraging registration are:

- The ultimate objective of the regulatory system is to achieve compliance. If the firm and its principals are coming to the regulator attempting to comply, and they don't have prior disqualifying events (e.g., under Section 204 of the Uniform Securities Act) to report on the Form BD or the accompanying U-4s for the owners and representatives, then it better serves the regulatory purpose to permit registration without prior inquiry.

- The act of registration does not cleanse prior misconduct , and if the regulator later learns of improper action it has both its prior powers and the new ability to impose sanctions against a registration.

- Later inspections are likely to disclose serious misconduct.

- Customers with problems understand that they should contact specific regulatory bodies which are identified more clearly to them.

- Registration will alert those with whom they have dealt in the past to the issue of whether registration was required in previous transactions involving the finder, and hence to any rights they may have arising out of those transactions in the event the investment has turned sour.

The arguments for disclose and sanction are:

- Wrong-doing has occurred, and we are responsible for punishing wrong-doing.

- It is better to identify any problems before the broker-dealer is permitted to do business in this state.

- The deterrent effect of such sanctions will discourage improper conduct by others.

We suggest that there are compelling reasons to take the more lenient approach. Our objective, and hopefully that of regulators, will be to establish an environment in which at least several hundred entities and individuals will come forward to register either as broker-dealers or as agents of those broker-dealers. We believe that the number of potential registrants runs to well over 1000, though the capacity in which they register is yet to be determined.

The manner in which the states treat disclosures of prior sales by unregistered persons vary. In some states, any disclosure of prior conduct without registration will involve enforcement action, though the sanction may be small in terms of fine. The concern for a new registrant is more of reputational harm than for the amount of the fine. In other instances states will simply issue a letter of caution or get an informal commitment regarding future compliance. This latter approach raises far less of a concern. Finally, if the level of participation is substantial, the sanction may also be substantial, which is a major deterrent for voluntary compliance when there are no complaints to the regulators.

We urge a “don’t ask, don’t tell” policy to accommodate this opportunity, as least for a reasonable window of time. This would allow broker-dealers to register without having to disclose the details of any prior unregistered conduct as part of the registration process. This reduces the risk that potential registrants will eschew the registration process and continue to engage in activities without registration. This policy would obviously not prevent a regulator from taking action in light of information independently gathered.

There are also equitable reasons for considering a more lenient approach. The question of required broker-dealer registration in states is not as well-pronounced as that at the federal level. There is much lore about the number of permitted "deals" before registration is required.

VII. EXEMPTIONS FOR UNREGISTERED BROKER DEALERS.

Some attorneys have suggested that providing for an exemption for Private Placement Broker-Dealers is a better alternative than a regulatory/registration scheme.

Given initial resistance from the various regulators and the fact that providing an exemption is not going to address all of the current abuses involving unlicensed PPBDs, creating an exemption is not currently a better alternative to a relaxed regulatory scheme. We believe such an approach would be rejected by litigators summarily.

Although providing for a limited exemption for Private Placement Broker-Dealer activities is a possible alternative, there are practical, and more importantly, political considerations that would make the ultimate viability of an exemption alternative extremely unlikely.

There have been suggestions that creating an exemption that would encompass certain PPBD activity would be a straightforward method for addressing the issues that have been raised by the Task Force. It has been suggested that the Task Force follow an approach similar to that used for the Rule 3a4-1 broker-dealer exemption for certain employees of an issuer with compensation permitted. It is far from clear that there could be agreement as to what limited conduct would qualify for the exemption. For example, would there be enormous support for an exemption which applied to simply introducing buyers to sellers no more than three times in any one twelve month period and refraining from any advertising or general solicitation of new business? An exemption narrow enough to satisfy the regulators would not cover a wide enough range of conduct to be meaningful to the universe of unlicensed finders.

In addition, an exemption would not address the current concern regarding the number of unscrupulous parties that are engaged in these activities. Indeed, creating an exemption would be likely to exacerbate the situation by permitting these parties to hide behind the available exemption. In contrast, a registration system would permit parties to determine whether the individuals they are contracting with to provide finder services are in compliance with applicable law. Even if an exemption is available, it would not solve the problem of NASD registered brokers being prohibited from co-venturing (share commissions) with exempt finders because the exempt parties would not be members of the NASD.

Notwithstanding these practical hurdles, we perceive that regulators view creating an exemption is unlikely because of the current political environment and the impact it would have on the existing regulatory scheme. In November 2001, the PPBD Task Force met with

representatives of the various regulators and were told that creating an exemption was not a practical solution. It was made clear to the Task Force that in order to reduce requirements in the broker-dealer registration process, the NASD would require a review of the entire registration process for broker-dealers. Also, creating an exemption would raise the political question among NASD members as to why an exemption was being made available to address one type of broker-dealer activity and not others. In general, the regulators were of the view that the current regulatory scheme adequately addressed the finder concern. As a result, the possibility of achieving a solution through a relaxed registration process appears to be far more likely than providing for an exemption to the existing regulatory scheme.

Even if a federal exemption were created, the issue remains of the coordination among the state regulatory agencies for any exemption that is created. Without federal preemption, which clearly would not occur, each of the states would have to adopt the form of exemption that is created at the federal level. Obtaining uniformity among the states can be a major challenge as evidenced in the variations in state uniform offering exemptions.

VIII. PROBLEMS IN COMPLIANCE WITH THE PRESENT REGULATORY SYSTEM FOR FINDERS.

IX. RECOMMENDATION.

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