



SEC TAKES AIM AT FINDERS

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Does it really matter to a TIC Sponsor if its broker or finder is licensed? TIC Sponsors should take immediate note of an action taken by the Securities and Exchange Commission (the “SEC”) on June 19, 2009. By Administrative Order, the SEC found Michael E. Fein and Stephen E. Saltzstein in willful violation of the broker-dealer registration provisions of Section 15(a) of the Securities and Exchange Act (the “1934 Act”). The primary offense in this case was not fraud, embezzlement, improper handling of funds, or any other type of typical misconduct. Rather, the primary offense was that Mr. Fein and Mr. Saltzstein were acting as brokers but were not licensed. In other words, Mr. Fein and Mr. Saltzstein introduced potential investors, helped structure transactions, and actively solicited investors and, in return, received commissions based on the amount of money invested. As a result of these activities, the SEC shut down their business, suspended Mr. Fein and Mr. Saltzstein from associating with any broker or dealer for up to 12 months, and required each of them to pay more than \$500,000 in fines, interest and penalties.

If a TIC Sponsor compensates unregistered individuals for introducing and soliciting investors, the compensated-individual or entity may be in violation of the broker-dealer registration provisions of the 1934 Act.¹ In some instances, however, a TIC Sponsor may compensate finders for very limited activities. If TIC Sponsors are considering using unregistered brokers or finders, the TIC Sponsor should carefully consider the following information. This discussion is limited to federal securities laws but state securities regulators have also been aggressive in looking for unregistered broker-dealers.

1. Broker- Dealer Registration and Finders.

Section 3(a)(4) of the 1934 Act defines a broker as “any person engaged in the business of effecting transactions in securities for the account of others...” (emphasis added). Section 15(a)(1) of the 1934 Act requires a broker to be registered with the SEC, or, if a natural person, to be associated with a registered broker-dealer, in order “to effect any

transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security . . .).” Section 15(a)(2) of the 1934 Act gives the SEC the power “by rule or order, as it deems consistent with the public interest and the protection of investors, [to] exempt from [registration] any broker or dealer...” Through a series of no-action letters issued by the SEC, an exemption from registration as a broker has developed for “finders.”

In general, “finders” are not subject to registration as brokers because they do not “effect” securities transactions, but merely “find” and place in contact potential buyers and sellers of securities who then negotiate and complete any resulting transactions. Pursuant to no-action letters issued by the SEC, the application of Section 15 to “finders” ultimately depends on two factors: (a) how the finder is compensated; and (b) the nature of the finder’s activities.

2. Type of Compensation Received by the Finder.

Under the SEC’s no-action letters, the types of activities that a finder is permitted to engage in without registering as a broker seems to vary

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somewhat with the type of compensation that the finder receives. The key determinant is whether the finder’s compensation is “transaction-based.” Compensation is deemed to be transaction-based if it varies with and is tied to the number and dollar amount of securities sold by the TIC Sponsor. The SEC is more suspicious of finders activities when compensation is based on the outcome of securities transactions.

¹The consequences of failing to register can include civil injunctions, civil money penalties, cease and desist orders, criminal prosecution (fine and imprisonment), denial of a later application for broker-dealer registration, and void contracts. See Sections 15(b)(4)(C), 21(d), 21A, 21C, 29(b) and 32(a) of the 1934 Act.

Transaction-based compensation provides a powerful incentive for finders to conduct sales efforts and engage in activities associated with brokers.² As a result, the SEC's staff may believe that such arrangements implicate greater protection -- a protection which is achieved by requiring the finder to register as a broker.

3. Nature of the Finder's Activities.

If the finder's compensation is transaction-based, the finder's activities should generally be limited to introducing the potential investor to the TIC Sponsor or registered broker. Any activity beyond mere introductions is severely scrutinized by the SEC staff and is likely to cause the SEC staff to conclude that the finder should be licensed as a broker.

In three no-action letters³ in which the SEC staff allowed the finder to receive transaction-based compensation without registering as a broker, the staff's conclusion was based upon the finder's only introducing the prospective investor or providing a list of prospective investors' names and telephone numbers to the issuer. In each case, the finder had a bona fide pre-existing business or personal relationship with parties whom the finder reasonably believed to be "accredited investors," as defined in Regulation D under the Securities Act of 1933. Activities which the SEC staff noted as not being done, and therefore potentially important in particular circumstances, included the following:

- a. delivering a copy of the prospectus to the potential investor;
- b. offering the security to or soliciting offers from potential investors;
- c. participating in any negotiations between the issuer and potential investors;
- d. making any recommendations or providing any advice relating to the valuation of or the financial advisability of the investment;
- e. preparing documentation required (under state law) to consummate the sale;
- f. participating in any advertisement, endorsement or general solicitation regarding an investment in the securities offered;
- g. participating in the preparation of any materials (including financial data or sales literature) or in the distribution of such materials to potential investors;

- h. performing any independent analysis of the issuer or its securities or engaging in any due diligence activities regarding the same;
- i. handling any funds or securities; or
- j. in the Paul Anka case, having any contact with potential investors concerning the issuer or the securities offered, either before or after directors, officers or employees of the issuer contacted the potential investors.

If the finder's compensation is not transaction-based, the scope of finder activities permitted by the SEC staff seems somewhat broader. In particular, the SEC staff has permitted finders who do not receive transaction-based compensation to engage in the following activities without registering as a broker:

- a. Providing information to clients regarding the securities and services offered by a broker to whom referrals were made, through the distribution of sales materials, where the finder did not discuss the merits of a particular security;
- b. Providing administrative services to the broker, including asking the prospective investor to complete biographical and financial questionnaires previously prepared by the broker after telling

“...the compensated-individual or entity may be in violation...”

the investor that the broker would use the information provided to determine whether to follow-up (the finder also reviewed the questionnaires for completeness and forward them to the broker);

- c. Introducing the prospective investor in person or over the telephone;
- d. Collecting financial information from potential investors, as prescribed by the broker, as well as verifying that the information provided is complete; and
- e. Arranging and attending meetings between the client and the broker.⁴

² See J. Polanin, Jr., The “Finder’s” Exception From Federal Broker-Dealer Registration, 40 Cath. U.L. Rev. 787, 797 (1991).

³ See Moana/Kauai Corporation, SEC No-Action Letter, LEXIS 412 (August 25, 1974), Paul Anka, SEC No-Action Letter, LEXIS 925 (July 24, 1991), and John DiMeno, SEC No-Action Letter, LEXIS 2791 (April 1, 1979).

A finder's participation in substantive discussions with the prospective investor is troublesome. The finder cannot recommend the TIC Sponsor or the securities offered. Answering questions from prospective investors is also an especially sensitive area. In order to be safe, if asked, the finder should refer the prospective investor to the offering memorandum and a registered broker or the TIC Sponsor for answers to questions regarding the merits of the investment. A finder must not become involved in negotiations with the prospective investor or discuss the details and merits of the investment.

As demonstrated by the recent Administrative Order, the SEC may be taking aim at finders. The next step could possibly be actions for rescission brought by disgruntled investors against TIC Sponsors, asserting that there was no exemption from registration for what the TIC Sponsor believed was a proper Regulation D offering. If

commissions are paid to an unlicensed broker who has engaged in solicitation of investors, the terms of the Regulation D safe harbor may not have been met and a TIC Sponsor could be required to return the investment plus interest to the investor. Before TIC Sponsors consider compensating finders for introducing potential investors to an offering, TIC Sponsors should carefully consider whether the finders activities require licensing as a broker. If a finder is acting more like a broker, TIC Sponsors should avoid the relationship all together. ◀

⁴See BSC Financial Corporation, SEC No-Action Letter, LEXIS 814 (October 3, 1996); Wall Street Preferred Money Managers, SEC No-Action Letter, LEXIS 648 (April 10, 1992); Colonial Equities Corp., SEC No-Action Letter, LEXIS 862 (June 28, 1988). See also M Financial, SEC No-Action Letter, LEXIS 786 (June 14, 1988); Original Financial Information Centers of America, Inc., SEC No-Action Letter, LEXIS 2503 (August 31, 1987); Redmond

