



Law Firms as “Finders”: Beware of Broker-Dealer Issues

By Iryna Ivashchuk

Law firms should be careful in assisting their clients who seek debt or equity funding (and being compensated for doing so). By only identifying willing investors and receiving compensation, a law firm is considered a “finder” under a recent Denial of Non-Action Request issued by the Securities and Exchange Commission (“Commission”). “Finder” is someone who acts as an intermediary and is engaged in certain referral activities, which include, but are not limited to, introducing companies to potential investors or providing investment consulting services, finding investors for venture capital financings or for entities issuing securities, making referrals or splitting commissions with registered broker-dealers, hedge funds or mutual funds, or engaging in buying or selling a business involving securities (mergers and acquisitions). This role of a “finder,” while not registered as a broker-dealer under the Securities Exchange Act of 1934 (“Exchange Act”) (which governs the way the securities markets and their participants operate) is generally prohibited by both federal and state securities laws.

The Exchange Act provides that “it shall be unlawful for any broker or dealer. . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security... unless such broker or dealer is registered” with the Commission. The Exchange Act defines a “broker” as “any person engaged in the business of effecting transactions in securities for the account of others,” and a “dealer” as “any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise.” In summary, a broker acts as an agent, and a dealer acts as a principal.

The most important factor considered by the Commission in deciding whether someone must be registered as a broker/dealer is whether the activities involve compensation related to the outcome of the transaction. Other factors involve making specific investment recommendations, facilitating securities transactions by soliciting and negotiating the transaction, and regularly engaging in the business of effecting securities transactions.

A recent opinion by the staff of the Commission (“Staff”) regarding LAW FIRMS as “finders” shows that the Commission might view anyone who receives transaction-based compensation in a securities transaction as a broker under the Exchange Act. In May of 2010, the staff of the SEC Division of Trading and Markets (“Staff”) denied a no-action request by the Virginia-based law firm of Brumberg, Mackey & Wall, P.L.C. (“BMW”), stating that it might recommend enforcement action to the Commission if BMW refers its corporate client to potential investors in exchange for transaction-based compensation without registering with the Commission as a broker-dealer.

BMW was supposed to be paid a percentage of the amounts raised by its client (“Company”) through investments in equity or debt instruments of the Company by persons referred by BMW. In its Request for Non-Action, BMW argued that its registration as a broker-dealer would not be necessary, since the firm’s assistance would only be to introduce the Company to a limited number of its contacts and the potential for abuse would be lacking due to limitations placed on the firm’s role (such as the law firm not engaging in any negotiations on the Company’s behalf). Essentially, BMW represented that the law firm would only refer interested clients/contacts to the Company as a “finder,” but would not engage in a sales effort or negotiations.

The Staff stated that the receipt of transaction-based compensation is “a hallmark of broker-dealer activity” and that the proposed transactions would require broker-dealer registration notwithstanding the limited role of the law firm. The Staff explained that, in its opinion, the law firm would have “a salesman’s stake” in the proposed transactions.

This no-action letter appears to be a departure from the prior position of the Commission on “finders,” as expressed in Paul Anka, SEC No-Action Letter (July 24, 1991), where the Staff did grant a non-action request by the entertainer Paul Anka who acted as a “finder” for purchasers of limited partnership units of the Ottawa Senators Hockey Club.

The BMW no-action letter serves as a reminder that the law firms should be especially careful in making referrals when transaction-based compensation is involved. The potential consequences of non-compliance with the Exchange Act and failure to register as a broker-dealer include monetary penalties, injunctive actions by the Commission against an offender, denial by the Commission of a subsequent application to register as a broker-dealer, and the Commission referring the matter to the Attorney General for potential criminal prosecution.

Securities Exchange Act of 1934 § 15(a)(1), 15 U.S.C.A. § 78o(a)(1).

Securities Exchange Act of 1934 § 3(a)(4)(A), 15 U.S.C.A. § 78c(a)(4)(A).

Securities Exchange Act of 1934 § 3(a)(4)(A), 15 U.S.C.A. § 78c(a)(5)(A).

Brumberg, Mackey & Wall, P.L.E., SEC Denial of No-Action Request (May 17, 2010), available at <http://www.sec.gov/divisions/marketreg/mr-noaction/2010/brumbergmackey051710.pdf>.

Paul Anka, SEC No-Action Letter (July 24, 1991), available at http://www.securities.utah.gov/docs/Anka_Letter.pdf.