

[Securities Regulation Daily Wrap Up, BROKER-DEALERS—ABA panel seeks clarity on finders, \(Sept. 15, 2017\)](#)

Securities Regulation Daily Wrap Up

[Click to open document in a browser](#)

By [Mark S. Nelson, J.D.](#)

The broker-dealer panel at the ABA's 2017 Business Law Section Annual Meeting in Chicago urged regulators and Congress to clarify the legal status of finders. Panelists said greater certainty is needed because of the disparate no-action letters issued by the SEC and potentially conflicting court decisions that leave finders in limbo. The panel's timing matched that of the SEC's soon-to-expire Advisory Committee on Small and Emerging Companies (ACSEC), which earlier this week reiterated its view that the Commission should take action on finders and asked its successor, the Small Business Capital Formation Advisory Committee, to follow-up on seeking clarification of finders' status.

No one answers the phone. The ABA panel noted that even in the post-Jumpstart Our Business Startups (JOBS) Act environment, many of the nation's smallest businesses still cannot get the assistance they need to raise adequate levels of capital to fund future growth. One panelist recalled clients complaining that no registered broker member of the Financial Industry Regulatory Authority would take their calls. A draft of the ACSEC's latest report would confirm that many registered broker-dealers are uninterested in riskier, small transactions.

The alternative to using registered broker-dealers for capital raising brings many risks, including that despite the presence of some reputable non-registered finders, other finders may be unscrupulous. Faith Colish, counsel at Carter Ledyard & Milburn LLP, one of the speakers on the panel, formally titled Finding Capital: Broker-Dealer Registration After Paxton and Kramer, said capital raising had been "neglected" for a long time. Another panelist, Martin Hewitt, noted that inconsistent state laws further complicate the situation for finders.

Lack of clarity. The panels' moderator, Marlon Paz, partner at Seward & Kissel LLP, explained that Exchange Act Section 3(a)(4) is the starting point for determining if someone must be registered with the Commission. That section defines "broker" as "any person engaged in the business of effecting transaction in securities for the account of others." The question is where finders fit into this definition, if at all.

Colish and Linda Lerner, senior counsel at Crowell & Moring LLP, engaged in a mock debate in which they analyzed guidance from the SEC and court decisions that potentially conflict with the SEC's views. On one side are the several SEC no-action letters that may suggest the possibility that finders, who introduce parties that may engage in a securities transaction, would not have to be registered as brokers. But some of these no-action letters also have subsequent histories that could make them challenging to apply in practice.

For example, in the 1985 [Dominion Resources, Inc.](#) no-action letter, the Division of Trading and Markets (then called the Division of Market Regulation) said it would not recommend enforcement to the Commission under Exchange Act Section 15 if Dominion Resources, which had developed expertise in placing taxable and tax-exempt securities, offered these services to other businesses seeking advice on how to structure similar transactions. But five years later, the Division revoked its prior position noting "somewhat similar" instances where the staff had denied no-action requests.

The Division also noted changed circumstances since it issued its original reply to Dominion Resources. "In the intervening years, technological advances, including the advent of the Internet, as well as other developments in the securities markets, have allowed more and different types of persons to become involved in the provision of securities related services."

Also aligned with finders' interests, the panelists noted the 1991 [Paul Anka](#) no-action letter in which Anka had entered into an agreement with two Canadian entities to buy shares related to a hockey club and was later to

use his efforts to introduce potential accredited investors to the hockey club. The Division recommended against enforcement if Anka engaged in the specific activities stated in the no-action request letter.

The panelists said courts also have arrived at varied decisions in several recent cases. For example, the Eighth Circuit in [Collyard](#), a case involving Paul Crawford, who founded a business to aid small companies in capital raising, and whose related license had previously been suspended, invested his own funds in a small company and then entered into an agreement with a third party to refer investors to the company he had invested in for a commission; Crawford later agreed with the company itself to refer investors for a fee. The SEC sued claiming Crawford was a broker.

The Eighth Circuit applied a non-exclusive set of six factors previously adopted by the Sixth Circuit. Of those factors, the court said the SEC presented "undisputed" evidence that Crawford met all but the one regarding employment by the issuer (Crawford was not an employee of the company he had invested in and to which he was to refer investors). Ultimately, the court concluded there was no genuine issue of material fact that Crawford was a broker. The court also rejected Crawford's assertion that there is a "finder exception" or "finder defense" regarding registration under Exchange Act Section 15.

By contrast, the two featured cases on the ABA panel suggest that finders can limit their activities in a manner that does not implicate Exchange Act registration. In [Kramer](#), a case with numerous evidentiary issues, the district court determined that the SEC failed to show by a preponderance of the evidence that a person was a broker. In [Collyard](#), Crawford had raised [Kramer](#) in his defense, but the Eighth Circuit had rejected the comparison because the alleged broker in [Kramer](#) engaged in more limited activities.

The other featured case was that of Texas Attorney General Ken Paxton, whom the SEC had alleged was a broker with respect to his efforts to recruit investors for a technology company while serving as a Texas state representative. The SEC had argued that "control" over accounts is just a factor, while Paxton argued that control is an element of "broker" and that the SEC fell short of alleging that he "effected transactions" "for the account of others." The district court leaned heavily on [Kramer](#) and one other case in [concluding](#) that "control" is an element (not a factor) and that Paxton did not have "authority" over accounts and, thus, was not a broker under the Exchange Act.

ACSEC recommendation. The ACSEC's [draft final report](#) echoed much of what the ABA panelists said about the uncertainty for unregistered finders. According to the ACSEC, only 13 percent of Regulation D offerings involve brokers or finders, which the committee said likely results from two factors: "(a) a lack of interest from registered broker-dealers given the legal costs and risks involved in undertaking a small transaction and (b) the reluctance of those not registered as broker-dealers to provide assistance because of the ambiguities in the definition of 'broker.'"

The ACSEC report also noted the ABA's involvement in urging the Commission to adopt clearer rules for brokers and finders. In 2005, the ABA's Business Law Section (and other ABA sections) issued a [report](#) from the ABA's Task Force on Private Placement Broker-Dealers (panelist Colish was a member of the ABA task force) that urged the SEC and FINRA to provide desired clarity. The report provides a detailed explanation of why, under current laws, persons might be reluctant to engage in the activities of a finder. Chief among those reasons was the task force's observation that the SEC's Division of Trading and Markets appeared to be wary of finders, especially when they may receive transaction-based compensation.

Attorneys: Marlon Paz (Seward & Kissel LLP). Faith Colish (Carter Ledyard & Milburn LLP). Linda Lerner (Crowell & Moring LLP).

IndustryNews: AlternativeInvestmentFunds BrokerDealers Enforcement ExchangesMarketRegulation FraudManipulation InvestmentAdvisers InvestorEducation PrivatePlacements SecuritiesOfferings