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Regulatory: Your finder's fee agreement may not be enforceable

Until the SEC takes more definitive action, companies and finders should exercise great caution.

BY RANDY JOHNSON
December 28, 2011

A company raising capital through a private securities offering will often retain a finder to locate investors and possibly help negotiate the terms of the financing. It's fairly common for the company to agree to pay the finder a transaction-based fee tied to the amount of money raised through the finder's efforts. Unfortunately, this seemingly simple arrangement can be a trap for the unwary.

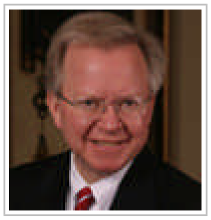
Unless the finder is licensed as a broker-dealer under federal and state securities laws, the agreement between the company and the finder is an illegal contract and is likely unenforceable. Failure to disclose the use of an unlicensed broker in the offering may also give investors a right to rescind their investment and may destroy the private offering exemption relied upon by the company to avoid registering the offering with the SEC.

Federal and state securities laws prohibit a person from being engaged in the "business of effecting transactions in securities" unless properly licensed or registered as a broker-dealer. Like many provisions in the securities laws, the interpretation of what constitutes the "business of effecting transactions in securities" is somewhat fuzzy. However, through various no-action letters, the SEC has provided some standards to help determine when the finder must be licensed.

Factors considered by a regulator in determining whether the finder must be licensed include whether the finder:

- Has been previously involved in the sale of securities
- Will be compensated with a transaction-based fee
- Will discuss details of the offering with potential investors or provide recommendations to the potential investors regarding the offering
- Is involved in the negotiations with the potential investors

About the Author



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