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## SEC'S NO-ACTION RELIEF PROVIDES GUIDANCE ON THE FINDER EXCEPTION TO BROKER-DEALER REGISTRATION

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The U.S. Securities and Exchange Commission ("SEC") staff issued its first guidance on the finder exception to the broker-dealer registration requirement under Section 15 of the Securities and Exchange Act of 1934 (the "Exchange Act") since March 2000 when it revoked a previously issued no-action letter. The new guidance, which clarifies when registration as a broker-dealer is required for business brokers, is contained in a November 8, 2006 no-action letter entitled Country Business, Inc.<sup>1</sup>

Section 15 of the Exchange Act requires that a broker or dealer register with the SEC if the broker or dealer effects any transactions in, or induces or attempts to induce the purchase or sale of, any security. The purpose of Section 15 is to protect the public by requiring brokers and dealers to adhere to the National Association of Securities Dealers, Inc.'s code of conduct and fair dealing. The scope of activities permitted by the exceptions to the Section 15 registration requirement is extremely narrow, and because the exceptions are not explicitly recognized in the federal securities laws, finders have had difficulty determining what activities trigger the broker-dealer registration requirement.

Much of the guidance with respect to the broker-dealer registration exceptions comes from SEC no-action letters. The two seminal no-action letters in this area were the Dominion Resources, Inc. ("Dominion Resources") no action letter and the Paul Anka no-action letter, issued in 1985 and 1991 respectively.<sup>2</sup> In March of 2000, however, the SEC staff revoked the Dominion Resources no-action letter, leaving little guidance for finders to determine whether they qualify as a broker-dealer for purposes of Section 15.

<sup>1</sup> Country Business, Inc., SEC No-Action Letter (Nov. 8, 2006).

<sup>2</sup> Dominion Resources, Inc., SEC No-Action Letter (August 24, 1985), *revoked* by Dominion Resources, Inc., SEC No-Action Letter (March 7, 2000); Paul Anka, SEC No-Action Letter (July 24, 1991).

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In the Dominion Resources no-action letter, the SEC staff outlined permissible activities of an intermediary in securities transactions and took the position that a finder, acting as a business broker, whose activities consisted mainly of selling businesses that were going concerns, was not required to register as a broker-dealer with the SEC. Furthermore, although the finder's fee was based on the overall size of the financing that the client arranged, the SEC staff concluded that the broker-dealer registration requirement was not triggered because the fee was not based upon successful issuance of securities. Relying on the SEC staff's position in this letter, many unregistered parties became involved in securities transactions.

In the Paul Anka no-action letter the SEC staff granted Anka's request for no-action relief from broker-dealer registration in connection with his proposal to locate investors for a hockey team attempting to raise money through an offering of its partnership units. The SEC staff took the position that "registration is not required for an individual who does nothing more than furnish to an issuer-offeror the names of persons the individual believes are potential investors in return for a transactional based finder's fee." The SEC staff granted the no-action request on the conditions that (i) the finder would not participate in any negotiations, solicitation of any investors or have any contact with the investors; (ii) the finder had not previously engaged in any negotiations, solicitation of any investors and had not had any contact with the investors; and (iii) the finder did not intend to participate in any securities distribution after completion of the instant offering. This exception to the broker-dealer registration requirement is quite limited in scope and applies only in situations in which the finder does almost nothing more than provide names and phone numbers of potential investors to the issuer. Despite its limited scope, this no-action letter is significant in that it permitted a commission-like fee arrangement without requiring the recipient of the fee to register as a broker-dealer.

In March 2000, the SEC narrowed its view of what role a finder may play in a securities transaction and revoked the Dominion Resources no-action letter. The SEC staff concluded that in light of technological advances and other developments in the securities markets which allowed more types of persons to become involved in the provision of securities-related services, Dominion Resources would no longer be permitted to conduct its activities without registering with the SEC pursuant to Section 15. As a result of the revocation, now nearly all intermediaries must be registered with the SEC unless one of the narrowly construed exceptions applies.

The Country Business, Inc. ("CBI") no-action letter is the first guidance the SEC staff has offered on the issue of finders referring investors to issuers since its revocation of the Dominion Resources no-action letter. CBI is a business broker for small businesses and in anticipation of providing services that are more extensive than simply acting as a finder of potential purchasers of businesses, CBI requested no-action relief from the SEC staff to engage in these activities without having to register as a broker-dealer. The SEC staff granted the request provided the following conditions were satisfied:

- (a) if a decision was made to effect the transaction by a sale of securities, CBI would have a limited role in negotiations between the seller and potential purchasers or their representatives and would not have the power to bind either party in the transaction;
- (b) the business represented by CBI was a going concern and not a "shell" organization;
- (c) the selling company, which CBI represented, satisfied the size standards for a "small business" pursuant to the Small Business Size Regulations issued by the U.S. Small Business Administration;
- (d) only assets would be advertised or otherwise offered for sale by CBI;
- (e) if the transaction was effected by means of securities, it would be a conveyance of all of the business's equity securities to a single purchaser or group of purchasers formed without the assistance of CBI;
- (f) CBI would not advise the two parties whether to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold (other than by valuing the assets of the business as a going concern);
- (g) CBI's compensation would be determined prior to the decision on how to effect the sale of the business, would be a fixed fee, hourly fee, a commission, or a combination thereof, that is based upon the consideration received by the seller, regardless of the means used to effect the transaction and would not vary according to the form of conveyance (i.e., securities rather than assets);
- (h) CBI's compensation would be received at the same times and in the same proportions as the seller received the consideration from the purchaser; and
- (i) CBI would not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.



The CBI no-action letter sets forth essentially the same conditions for unregistered business brokers as two no-action letters issued by the SEC staff in the late 1980's.<sup>3</sup> Together these letters highlight the fundamental characteristics of a broker, namely (i) negotiating the terms of a securities transaction, (ii) providing advice on the how to effect the transfer of a business by means of securities and valuing the securities to be sold, (iii) receiving compensation based on the securities transaction and (iv) assisting with the financing of the transaction.

The revocation of the Dominion Resources no-action letter left open the question of whether no-action letters issued after 1985 regarding broker-dealer registration exceptions reflect the SEC staff's current interpretations of these exceptions. The CBI no-action letter helps to answer that question by reaffirming previous interpretations of the registration exception for business brokers. At the same time, the CBI no-action letter is further evidence of the SEC's narrowing view of what role a finder may play in a securities transaction.

<sup>3</sup> See Victoria Bancroft, SEC No-Action Letter (July 9, 1987); International Business Exchange Corp. (Dec. 12, 1986). The only factor included in the CBI letter which was not included in these earlier no-action letters is the requirement that the finder limit its services to "small businesses."



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*This summary does not constitute legal advice or a solicitation of any particular prospective client. If you have questions or require advice please call your regular contact at Cozen O'Connor or Ralph V. De Martino by telephone at (202) 912-4800 or by e-mail at [rdemartino@cozen.com](mailto:rdemartino@cozen.com).*