Christopher Myers

Associate
702.669.4621
Las Vegas
crmyers@hollandhart.com

Reasons to be Wary of California's Finder Exemption

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On October 10, 2015, Governor Jerry Brown signed into law Assembly Bill 667 (AB 667), which exempts an individual who is a "finder" (as defined in AB 667) from the broker-dealer registration requirements of California's Corporate Securities Law of 1968 (CSL).

AB 667 defines a "finder" as a natural person who, for direct or indirect compensation, introduces or refers one or more accredited investors, as that term is defined in Rule 501(a) of Regulation D under the Securities Act of 1933, to an issuer or an issuer to one or more accredited investors, solely for the purpose of a potential offer or sale of securities of the issuer in an issuer transaction in California, and who does not engage in a lengthy list of enumerated activities.

To comply with AB 667 a "finder" must: (1) file a statement of information with the Department of Business Oversight (DBO), (2) pay a fee of $300, (3) make an annual renewal filing, (4) obtain the informed, written consent of each person introduced or referred by the finder to an issuer, in a written agreement signed by the finder, the issuer, and the person introduced or referred, and (5) maintain records for no less than five years. While seemingly daunting, the requirements of AB 667 pale in comparison to the rigorous licensing and examination process required to register as a broker-dealer with the SEC, FINRA and California Securities Division.

However, although AB 667 may seem like an answer to the prayers of California "finders" and issuers alike, all must be wary of the pitfalls of running afoul of the broker-dealer registration requirements under Section 15(a) of the Securities Exchange Act of 1934 (Exchange Act), which makes it unlawful for a “broker” or “dealer” 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 SEC. Indeed, while parties may strive to separate the activities of "finders" from broker-dealers, the activities of each can easily overlap, or, more likely, be deemed to have overlapped by a securities regulator, thereby exposing the compliant California "finder" and his/her client to liability under the Exchange Act.

Persons deemed to be acting as an unregistered broker-dealer may subject themselves to potential civil and criminal liability, including penalties, fines, suspension and disbarment. In addition, since Section 29(b) of the Exchange Act provides that contracts entered into in violation of the Exchange Act may be rendered void, the unregistered broker-dealer may not be able to enforce the fee agreement pursuant to which he or she was engaged as a "finder."

As to the issuer, consequences can include anything from being held criminally and civilly liable as an aider and abettor of the unregistered broker-dealer activity to being forced to offer rescission to all investors

introduced to the issuer by the unregistered broker-dealer.