Using Finders to Locate Investors – Bruce E. Methven

A number of years ago the SEC effectively banned the use of finders to locate investors for securities offerings that cross state lines. Still, a few states allow finders for their intrastate offerings (offerings made entirely within that state). California allows finders as a matter of case law. Other states that allow finders include Texas, Minnesota, Michigan and New York.

A finder is a person who is not licensed as broker-dealer but who is paid on a commission basis for locating investors. (Appropriately licensed broker-dealers always can be paid on a commission basis, but are very unlikely to get involved unless a large amount of money is being raised and the offering is an easy sell to investors.) Top officers of the offering company can sell their company's securities, but cannot be paid on any kind of performance basis. More specifically, they can only be paid on a salaried or hourly basis and must have significant duties other than sale of the securities. Lower-level employees cannot make sales, although they may be able to provide administrative assistance.

Rather than banning finders outright, federal law requires that a finder not receive any performance-based compensation. In other words, on the federal level a finder can be paid a flat amount or fixed amounts for time periods (hourly, monthly, etc.) regardless of performance, but not a percentage of money invested and not a payment per investor. Because offering entities virtually always are interested in finders only if they produce, this approach effectively bars finders on the federal level.

The general rule with finders in the states that allow them is that they can only introduce potential investors to the offering company. They cannot tout the investment, be involved in the sale process or any negotiations regarding terms or price, offer the securities, or advise either party. Subsequent contact between the finder and the potential investor after the introduction to the offeror can be taken as evidence that the finder was acting as a broker, so the finder should have minimal contact with the potential investor (at least until after the sale is closed), although some generic followup seems to be permitted.

If an offeror uses a finder, it is crucial that there be a signed, written agreement stating exactly what the finder can and cannot do – and stating that the finder indemnifies the company if the finder violates the law. Even then, offerors should only retain people as finder whom they trust to act responsibly, no "cowboys" or wild-and-crazy sales people. If a finder violates the law, it possible that could make the entire offering a violation of the securities laws.

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