FINDERS SLEEPERS: WHY RECENT STATE REGULATION OF FINANCIAL INTERMEDIARIES SHOULD ROUSE THE FEDERAL GOVERNMENT FROM ITS SLUMBER

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I. INTRODUCTION

America tends to notice only its most glaring deficiencies. Even so, the call for reform only grows louder when such deficiencies personally affect the privileged masses. From the plummeting value of the American dollar to the skyrocketing prices at the pump, the hornbook for American current events is largely comprised of what is impossible to ignore. There is, however, an equally disturbing trend lurking beneath the shadows and despite repeated pleas from the small business community, the federal government has refused to acknowledge and legitimize the increasing role of financial intermediaries in the capital-raising process.[1]

While innovation comes in all shapes and sizes, the need for start-up capital is common to most, if not all, of America's inventors and entrepreneurs.[2] Small businesses could historically rely on venture capitalists and mid-sized brokers for funding, but these sources of start-up capital have recently begun to run dry.[3] As a result, many small

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1. *See* Ronald Fink, *Finders Keepers: The SEC Is Hearing New Demands To Make It Easier for Small Companies To Raise Capital*, CFO MAGAZINE, Feb. 1, 2005, at 1, *available at* http://www.cfo.com/article.cfm/3598448/c_3666324?f=singlepage; *see also* Robert Connolly, Comment, *Legitimizing Private Placement Broker-Dealers Who Deal with Private Investment Funds: A Proposal for a New Regulatory Regime and a Limited Exception to Registration*, 40 J. MARSHALL L. REV. 703, 704 (2007).

2. *See* John L. Orcutt, *Improving the Efficiency of the Angel Finance Market: A Proposal To Expand the Intermediary Role of Finders in the Private Capital Raising Setting*, 37 ARIZ. ST. L.J. 861, 864 (2005).

3. *See* A.B.A. Task Force on Private Placement Broker-Dealers, *Report and Recommendations of the Task Force on Private Placement Broker-Dealers*, 60 BUS. LAW. 959, 968–69 (2005) [hereinafter A.B.A. Report].

businesses are forced to engage financial intermediaries, or finders, to seek out nontraditional sources of funding.[4] Many wonder, however, if finders are worth the risk.[5] Unlike professional broker-dealers, who are required to register with the U.S. Securities and Exchange Commission ("SEC"),[6] finders are a largely unregulated industry.[7] When a finder steps beyond the mere connection of buyers and sellers and becomes too involved in the securities transaction, he operates as an unregistered broker-dealer and exposes the transaction's participants to stiff SEC penalties.[8] Despite this "Catch-22" confronting small business owners, the SEC has failed to draw a clear line between lawful finding and unlawful broker-dealing.[9] This uncertainty in the federal arena has prompted some states to enact their own finder's legislation,[10] and rather than alleviating the tension, these state regulations present fresh problems of conflicting state and federal regimes.[11]

This comment argues that the current treatment of financial intermediaries in the capital-raising process is unresponsive to the changing landscape of the small business community. Not only does the SEC inadequately define the permissible role of a finder, recent legislation in Texas and South Dakota foreshadows the ills of a dual regulatory society. Rather than waiting for states to address the finder's dilemma on an ad hoc and inconsistent basis, the federal government should create an SEC-registered class of finders to facilitate capital formation and jumpstart a receding American economy. Part II examines the expanding role of financial intermediaries in small market financing and the SEC's less than desirable definition of a finder exempt from federal registration. Part III explains how Michigan, Texas, and South Dakota have addressed the finder's dilemma, and why their

4. *See* Connolly, *supra* note 1, at 729.

5. *Cf.* Virginia K. Kapner, *When Finders Bring Trouble: Avoiding Pitfalls of Working with Unlicensed Broker-Dealers*, BOSTON B.J., Jan.–Feb. 2003, at 14 (discussing the legal "pitfalls" and risks of using finders); Victor L. Zimmerman, Jr., *To Register or Not: A Finder's Big Dilemma: Those Who Assist Emerging Companies in Getting Investors Could Be Subject to Certain Federal and State Securities Laws*, THE NAT'L L.J., Jan. 22, 2001, at B9 (encouraging activity monitoring).

6. *See* 15 U.S.C. § 78o(a)(1) (2006).

7. *See* Nelson S. Ebaugh, *New Finder Rules in Texas: What a Tangled Web We Weave*, THE HOUSTON LAW., July–Aug. 2007, at 20, *available at* http://www.thehoustonlawyer.com/aa_july07/page20.htm.

8. *See* Kapner, *supra* note 5.

9. *See* Brad R. Jacobsen & Olympia Z. Fay, *Finding a Solution to the Problem with Finders in Utah*, 19 UTAH B.J. 38, 42, Apr. 24, 2006, *available at* http://www.utahbar.org/barjournal/archives/2006/04/finding_a_solut.html; Orcutt, *supra* note 2, at 903.

10. *See* Christine Hall, *New Rule Clarifies When 'Finders' Can Be Keepers*, HOUSTON BUS. J., Feb. 2, 2007, *available at* http://houston.bizjournals.com/houston/stories/2007/02/05/focus1.html.

11. *Cf.* Ebaugh, *supra* note 7, at 20 (explaining that a finder may comply with Texas securities law while violating federal securities law).

answers represent the problematic birth of a dual regulatory system. Part IV chronicles the thwarted development of past reform efforts and concludes by outlining the emerging consensus behind a federally-registered class of finders.

II. The Rise of the Finder and the Need for Clarity

The SEC was designed to ensure the integrity of the securities market by safeguarding investors and encouraging capital formation.[12] By ignoring the capital-raising problems of small start-up businesses, however, the SEC's regulatory scheme inhibits small business formation and effectively stymies the growth of the American economy.[13] The capital market demands the use of financial intermediaries, but under current law, small business owners are left guessing as to whether their involvement with an overactive finder will result in sanctions for employing an unregistered broker-dealer.[14] This section explains why finders are essential to future economic growth and how the SEC's failure to define finders exposes small business owners to severe and unnecessary risks.

A. The Small Business Funding Gap and the Increased Demand for Finder Services

The pockets of most entrepreneurs are not deep enough to provide all the funding necessary to turn their ideas into reality.[15] Instead, smaller start-ups must typically secure outside equity financing to fund their ventures.[16] Traditionally, this funding was readily provided by venture capitalists and mid-sized issuers, but in recent years, the pool of available start-up capital has evaporated.[17] Venture capitalists have focused their

12. *See* SEC, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, http://www.sec.gov/about/whatwedo.shtml (last visited Nov. 3, 2008) [hereinafter SEC, Investor's Advocate].

13. *See* A.B.A. Report, *supra* note 3, at 960 ("Small business capital formation is key to creating jobs in America. Small businesses create many more new jobs than large public companies who have no need for [financial intermediaries]."); Orcutt, *supra* note 2, at 861 ("The continuous creation of new rapid-growth start-ups plays a substantial role in the success of the U.S. economy."). *See generally* Asli Demirgüç-Kunt & Ross Levine, *Finance, Financial Sector Policies, and Long-Run Growth*, (World Bank, Policy Research Working Paper No. 4469, 2008), *available at* http://papers.ssrn.com /sol3/papers.cfm?abstract_id=1081783#PaperDownload (discussing the relationship between finance policy and economic growth).

14. *See* Jacobson & Fay, *supra* note 9, at 38–39; Zimmerman, *supra* note 5.

15. *See* Orcutt, *supra* note 2, at 869.

16. *See id.*

17. *See* A.B.A. Report, *supra* note 3, at 968–69.

efforts on larger ventures in later stages, and mid-sized brokerage firms have either disappeared or have been subsumed by bigger firms with grander schemes.[18] The result is a small business market gap where start-ups seeking $250 thousand to $5 million are denied access to traditional markets and are funneled into nontraditional streams of income.[19] Financial intermediaries thus become an essential conduit by which entrepreneurs can connect to potential investors.[20] This compelled interaction between desperate start-ups and nontraditional investors has created a semi-underground market of unregulated finder activity.[21]

Though the finder's market ultimately puts start-up capital into the hands of small business owners, an unregistered finder can easily cross the line into unlawful broker-dealership if he becomes too involved in the securities transaction.[22] The Securities and Exchange Act ("Exchange Act") prohibits unregistered persons from effecting any

18. *See id.* Venture capitalists and other brokers have replaced smaller deals with larger deals for a number of reasons. *Id.* at 968. Mainly, though, larger deals reap significantly larger rewards while bearing elements of time, risk, and transaction costs that are comparable to smaller deals. *See id.* at 968–69; *see also* Fink, *supra* note 1 (describing how "federally registered broker-dealers that might once have provided capital have either gone under or merged into larger investment banks that don't consider start-ups worth their time").

19. *See* Orcutt, *supra* note 2, at 874; *see also* Lee R. Petillon & Mark T. Hiraide, *CA: Private Offerings Using Non-Registered Broker-Dealers*, ACTIVE CAPITAL, 2005, *available at* http://activecapital.org/story?story_id=20094 (explaining that companies seeking less than $5 million in start-up capital "find it difficult to attract investment bankers who are registered broker/dealers, as such small offerings are not economic for the broker/dealer"). In their seed stages, entrepreneurial groups can typically raise $250,000 themselves. Orcutt, *supra* note 2, at 874–75. Larger entities further along in their development, on the other hand, can typically secure $5 million or more from more-than-eager venture capitalists. *Id.* Many of the larger brokerage firms are not even willing to fund $5 million deals, setting their floor at $25 million. *See* A.B.A. Report, *supra* note 3, at 968; Connolly, *supra* note 1, at 704.

20. *See* Connolly, *supra* note 1, at 704; *see also* Sherman A. Cohen, et. al., Finders, Broker-Dealers, and the Gray Area in Between, *available at* http://www.agg.com/Contents/PublicationDetail.aspx?ID=910 (last visited Nov. 3, 2008) ("If history is any guide, many companies will use 'finders'—a match-maker of sorts for the cash needy and the financially flush."). Another beneficiary of the capital funding squeeze is the angel investor market, which is comprised of wealthy, accredited investors providing start-up capital to fledgling businesses. *See* Orcutt, *supra* note 2, at 874–75; Zimmerman, *supra* note 5. As of the turn of the decade, angels were funding between thirty and forty times as many start-ups as venture capitalists. Zimmerman, *supra* note 5 (citing MARK VAN OSNABRUGGE & ROBERT J. ROBINSON, ANGEL INVESTING 69 (2000)).

21. The American Bar Association has referred to the unregulated finder's market as a "vast and pervasive 'gray market' of brokerage activity" typified by uncertainty and risky behavior. *See* A.B.A. Report, *supra* note 3, at 959; *see also* Hugh Makens, *Capital Formation: Making Finders Viable*, Government-Business Forum on Small Business Capital Formation, Sept. 20, 2004, at 4, *available at* http://www.sec.gov/info/smallbus/hmakens.pdf ("Problems relating to unregistered finders have been particularly prominent in the raising of early stage capital for smaller business. I believe that there is a vast 'gray market' of unregistered brokerage activity where the funding for these companies, who generally can't access traditional brokerage firms for underwritings, is often obtained through unregistered financial intermediaries.").

22. *See* Kapner, *supra* note 5.

transactions in securities,[23] and violations invite swift and severe penalties.[24] Finders are potentially subject to monetary damages,[25] civil injunctions enjoining future participation in securities activities,[26] and criminal prosecution, if the violation was willful.[27] A similar strategy can be employed against issuers,[28] and investors often retain the right to rescind their securities purchase.[29] On top of the heightened risk of statutory penalties, the finder's market also exposes its participants to a higher rate of fraud than traditional capital markets.[30] Unlike broker-dealers, who are registered and monitored by the SEC, finders are a largely unregulated community with their fair share of unsavory and unsophisticated individuals.[31] Despite the endemic risks of employing unregistered third parties to secure capital, the venture may not survive without a financial intermediary, and because of this, finders have become a necessary evil in the small business community.[32]

B. The SEC's Failure To Define the Lawful Activities of a Finder

Given the seriousness of employing an unregistered broker-dealer, an ideal regulatory environment would clearly define the permissible role of a finder in the capital-raising process.[33] Unfortunately, the SEC's characterization of a lawful finder is blurry at best, and small businesses are forced to determine whether their use of a finder is illegal on a case-by-case basis.[34] Best practices define a finder as a person who connects buyers and sellers of securities for a flat fee and then disappears from the

23. 15 U.S.C. § 78o(a)(1) (2006).
24. *See* Jacobsen & Fay, *supra* note 9, at 39–40.
25. 15 U.S.C. § 78u-2(b) (2006).
26. *Id.* § 78u(d).
27. *Id.* § 78ff(a).
28. Orcutt, *supra* note 2, at 925.
29. *Id.* at 925–26; *see also* Kapner, *supra* note 5.
30. *See* Fink, *supra* note 1 (explaining that because finders are exempt from the burdens of federal registration, the current finder's market leaves "more of the field to those inclined toward fraud").
31. *See id.*; *see also* Hall, *supra* note 10 (stating that the presence of "bad people" prompted Texas to enact its finders legislation). *But see* A.B.A. Report, *supra* note 3, at 961 (comparing finders to social drinkers during prohibition who are otherwise "ethical and honest individuals"). Despite the actual composition of the money-finding community, the point remains that its members do not fall within the SEC's regulatory authority until they visibly err. Such an unregulated community undeniably engenders a vast potential for fraudulent activity. *See* Fink, *supra* note 1; *see also* Hall, *supra* note 10.
32. *See* Jacobsen & Fay, *supra* note 9, at 42 ("Small businesses and start-up companies in need of investment capital are often in a 'Catch-22' when it comes to raising funds. Without additional capital, such companies may not survive, but if they raise capital through the use of a finder, they will likely be violating the law which, in turn, may lead to their demise.").
33. *See* A.B.A. Report, *supra* note 3, at 959–60.
34. *See id.*

transaction.[35] Because the uncertainty surrounding the distinction between finders and broker-dealers remains a driving force behind the call for reform,[36] a detailed examination of the SEC's elusive finder inquiry is warranted.

The logical starting point in the broker-dealer versus finder distinction is the controlling statute. The Exchange Act defines broker-dealers as persons "engaged in the business of effecting transactions in securities,"[37] and while finders are not explicitly referenced, they enjoy a de facto exception to the broker-dealer registration requirement.[38] The SEC also maintains an online compliance guide that lists several intermediary activities invoking broker-dealership.[39] The concept behind the Exchange Act and the compliance guide is simple: a legal finder becomes an unlawful broker-dealer when he becomes too active in facilitating securities transactions.[40] The SEC has consistently declined to draw a mathematical bright line between permissible and impermissible finder activities,[41] and as a result, sellers, investors, and their counsel have been forced to test the waters by soliciting no-action letters from the SEC staff.[42] While these letters are intended to clarify

35. *Id.* at 966 (quoting ALAN J. BERKELEY & ALISSA J. ALTONGY, REGULATION D OFFERINGS AND PRIVATE PLACEMENTS 51 (2001)).

36. *See* A.B.A. Report, *supra* note 3, at 974 ("[T]he present system really does not work well for regulating many financial intermediaries. Often intermediaries play a very limited role in transactions, but in order to engage in securities transactions, broker-dealer registration is required in a manner that may be more appropriate to a full-service firm.").

37. Brokers and dealers are separately defined by the Exchange Act. *Compare* 15 U.S.C. § 78c(a)(4)(a) (2006) (defining brokers as "any person engaged in the business of effecting transactions in securities for the account of others"), *with id.* § 78c(a)(5)(a), defining dealers as "any person who is engaged in the business of buying and selling securities for such person's own account through a broker or otherwise"). The term broker-dealer has been commonly applied to all persons engaged in the business of effecting transactions in securities. *See* David A. Lipton, *A Primer on Broker-Dealer Registration*, 36. CATH. U. L, REV. 899, 909–10 (1987).

38. Finders are arguably engaged in the business of effecting securities transactions for both buyers and sellers, albeit in a limited fashion. *See* Connolly, *supra* note 1, at 723; Lipton, *supra* note 37, at 927. Despite seemingly falling within the purview of the Exchange Act's registration requirements, securities law has carved out an authoritative de facto finder's exception. *See* Lipton, *supra* note 37, at 927.

39. SEC, Guide to Broker-Dealer Registration, http://www.sec.gov/divisions/marketreg/bdguide.htm (last visited Nov. 3, 2008) [hereinafter SEC, Guide]. Notably, the compliance guide advises financial intermediaries that they may need to register as a broker-dealer if they find investors for, make referrals to, or split commissions with registered broker-dealers, venture capital or "angel" financing, private placement, or other securities intermediaries. *Id.*

40. *See* 15 U.S.C. § 78c(a)(4)(A), 78c(a)(5)(A); SEC, Guide, *supra* note 39.

41. *See* Orcutt, *supra* note 2, at 903–04.

42. *See id.* John Polanin, Jr. defines a no-action letter as "a response from the staff of the Commission to an inquiry requesting assurances in connection with a proposed transaction implicating the federal securities laws. Based on the facts and representations set forth in the inquiry, the staff states that it will not recommend enforcement action to the Commission if the parties making the request proceed as they describe, without complying with specific statutory or regulatory provisions of those laws."

the law, they are limited to the facts and parties specified, and they do not constitute binding authority.[43] Nevertheless, the SEC staff has identified the following badges of broker-dealer activity:

> (1) receipt of transaction-based compensation;
> (2) extensive involvement in the securities transaction, including:
>
> > (a) valuations of the prospective transaction;
> > (b) involvement in negotiations; and
> > (c) assistance with the structure of the transaction;
>
> (3) active solicitation of securities investors; and
> (4) prior involvement in securities transactions and/or prior discipline for securities activities.[44]

As explained below, the presence of any one of these factors may be enough to require broker-dealer registration. Taken as a whole, the staff's systematic restriction of a finder's permissible activities is particularly troublesome considering the rising demand for finder services.[45]

1. Transaction-Based Compensation

Transaction or success-based compensation is probably the best indicator of a broker-dealer.[46] When an intermediary's commission is based on the ultimate success of the transaction—as opposed to a flat referral fee—the intermediary acquires a financial stake in the transaction and the risk of abuse is heightened.[47] For example, in the *Herbruck, Alders & Co.* no-action letter, the SEC staff noted that transaction-based compensation was "a key factor that may require an entity to register as a broker-dealer," and "[a]bsent an exemption, an entity that receives securities commissions. . . is [generally] required to

John Polanin, Jr., *The "Finder's" Exception from Federal Broker-Dealer Registration*, 40 CATH. U. L. REV. 787, 789 n.15 (1991).

43. *See* Orcutt, *supra* note 2, at 904 ("Because no-action letters are purely matters between the SEC staff and the party making the request, and because they are limited to the specific facts of the requesting letter, it is risky for other parties to draw general conclusions from these letters."); *see also* Lipton, *supra* note 37, at 985 (arguing that "[t]he practice of relying heavily upon no-action letters to provide advice to potential brokers must be revisited").

44. *See* Orcutt, *supra* note 2, at 904–05; A.B.A. Report, *supra* note 3, at 975; 69 Am. Jur. 2d Securities § 328 (2008). In addition to these general factors, it is essential to remember the basic goal of investor protection: the prevention of abusive sales practices. *See* Orcutt, *supra* note 2, at 928–29. All of these factors expose the consumer to a greater risk of fraud or deception, and as a result, the SEC staff is more likely to require broker-dealer registration. *See id.*

45. *See* Orcutt, *supra* note 2, at 928–29.

46. *See* A.B.A. Report, *supra* note 3, at 975–76.

47. *See id* at 977.

register as a broker-dealer."[48] Although transaction-based compensation raises a strong presumption of broker-dealership, finders may be able to escape registration if they are a one-time finder who will be wholly removed from all other aspects of the transaction.[49] Many finders attempting to avoid registration with a success-based compensation scheme rely on the *Paul Anka* no-action letter.[50] In the *Anka* situation, Anka was retained by the Ottawa Senators Hockey Club to find potential purchasers for limited partnership units.[51] He would provide the Senators with names and telephone numbers, but would not contact the investors with any recommendations.[52] Even though he would receive ten percent of any sale, the SEC staff did not require Anka to register as a broker-dealer because he played a minor role and his finder's activities were limited to this one transaction.[53]

Paul Anka represents the outer limits of permissible activity and cannot be relied on with any degree of assurance.[54] First, the favorable SEC ruling was limited to *Paul Anka*'s specific facts and those facts alone.[55] Second, recent SEC no-action letters have called *Paul Anka*'s principles into question.[56] Most notably, the staff revoked its 1985 *Dominion Resources* letter, which granted no-action relief in spite of Dominion's transaction-based compensation.[57] This revocation has led some commentators to believe that the staff may be "moving to a position where the existence of transaction-based compensation alone may be sufficient to trigger broker-dealer registration."[58]

48. Herbruck, Alder & Co., SEC No-Action Letter, 2002 WL 1290291, at *2 (June 4, 2002); *see also* Mike Bantuveris, SEC No-Action Letter, 1975 WL 10654, at *4 (Oct. 23, 1975) (recommending registration when a consulting firm would "receive fees for its services that would be proportional to the money or property obtained by its clients and would be contingent upon such transactions in securities").

49. *See* Orcutt, *supra* note 2, at 913–14.

50. *See* Paul Anka, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,797, at 78580–81 (July 24, 1991).

51. *Id.* at 78,580.

52. *Id.* at 78,580–81.

53. Id. at 78,581; *see also* A.B.A. Report, *supra* note 3, at 976–77 (noting that the favorable letter was likely due to Anka's "uniquely limited duties" and "the one-time occurrence of the event").

54. *See supra* note 40 and accompanying text; *see also* Orcutt, *supra* note 2, at 904 (warning practitioners about the dangers of relying on SEC no-action letters)

55. *See* A.B.A. Report, *supra* note 3, at 977.

56. *See id.*; Orcutt, *supra* note 2, at 913.

57. Dominion Resources, SEC No-Action Letter, 2000 WL 669838 (June 1, 2000) [hereinafter Dominion 2000]; Orcutt, *supra* note 2, at 913.

58. A.B.A. Report, *supra* note 3, at 977; *see also* Orcutt, *supra* note 2, at 913 (arguing that the present SEC staff might not issue a favorable letter if presented with the same fact pattern as *Paul Anka*).

2. Extensive Involvement in the Securities Transaction

The more active a finder is in effecting a securities transaction, the higher the risk of abusive trade practices, and the higher the likelihood that the finder will be considered a broker-dealer.[59] Because the pure finder merely connects two parties and disappears, any investment recommendation, negotiation participation, or transactional assistance by a finder raises an immediate red flag.[60] As the staff pointed out in *May-Pac Management Co.*, "persons who play an integral role in negotiating and effecting. . . transactions in securities... are [generally] required to register with the Commission."[61] To contrast activities that require registration with activities that do not, compare the staff's disposition in *May-Pac* and *Victoria Bancroft*. In *May-Pac*, registration was required for a company that would connect buyers and sellers, help negotiate the deal, and advise its client on the merits of any offer received.[62] In *Bancroft*, registration was not required for a licensed real estate broker who created a list of potential purchasers and introduced them to sellers of financial institutions.[63] After Bancroft introduced the parties, she disappeared from the deal and did not negotiate, make recommendations, give advice, or assist with the financing.[64]

Many SEC letters consider when a finder crosses the line into broker-dealership,[65] and similar to the trend in transaction-based compensation, the SEC has consistently narrowed the scope of a finder's permissible activities.[66] Again, much of this can be attributed to the 2000

59. *See* Orcutt, *supra* note 2, at 928–29.

60. *See id.* at 906 (stating that "[m]aking investment recommendations or participating in negotiations surrounding the securities transaction appear to be 'practically' dispositive factors").

61. May-Pac Mgmt. Co., SEC No-Action Letter, [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,679, at 83,835 (Dec. 20, 1973).

62. *See id.* at 83,834–35; *see also* A.B.A. Report, *supra* note 3, at 978 (discussing *May-Pac*).

63. Victoria Bancroft, SEC No-Action Letter, 1987 WL 108454, at *1 (Aug. 9, 1987).

64. *Id.*

65. For a sense of what activities require registration, see Capital Directions, Inc., SEC No-Action Letter, 1979 WL 14878, at *1, *3–4 (Jan. 4, 1979); Mike Bantuveris, SEC No-Action Letter, 1975 WL 10654, at *1, *3–4 (Oct. 23, 1975); May-Pac Mgmt. Co., SEC No-Action Letter, [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,679, at 83,835 (Dec. 20, 1973); Fulham & Co., Inc., SEC No-Action Letter, 1972 WL 9129, at *2 (Dec. 20, 1972). To discover when a finder's activities do not require registration, see Dana Inv. Advisors, Inc., SEC No-Action Letter, 1994 WL 718968, at *14–17 (Oct. 12, 1994); Paul Anka, SEC No-Action Letter, [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,797, at 78,580–81 (July 24, 1991); Colonial Equities, Corp., SEC No-Action Letter, 1988 WL 234557, at *6, *9–14 (June 28, 1988); John DiMeno, SEC No-Action Letter, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,940, at 81,271 (Oct. 11, 1978); Samuel Black, SEC No-Action Letter, 1977 WL 14905, at *2–3 (Jan. 20, 1977); Moana/Kauai, SEC No-Action Letter, 1974 WL 8804, at *3–4 (Aug. 10, 1974).

66. *See* Orcutt, *supra* note 2, at 907–08.

revocation of the 1985 *Dominion Resources* letter.[67] In 1985, the staff granted no-action relief even though Dominion would: (a) analyze the financial needs of its clients; (b) recommend securities to fit its clients' needs; (c) arrange lawyers and broker-dealers to structure the transaction; (d) make itself available as a consultant; and (e) participate in negotiations.[68] Relying on the staff's favorable treatment, many finders felt confident that playing an active role in effecting a transaction was not a *per se* activity of a broker-dealer.[69] The SEC gave two reasons for revoking its 1985 letter. First, "technological advances . . . allowed more and different types of persons to become involved in the provision of securities-related services."[70] The implication is with more people using better technology, the risk of abusive sales practices has increased.[71] Second, the staff noted that since its letter in 1985, it had denied no-action requests in similar situations.[72]

Straddling the line between a finder and a broker-dealer is a risky proposition.[73] Even though giving advice to the client, negotiating the deal, and structuring the transaction may not always require registration, these activities seriously weaken a finder's case for no-action relief. A much safer finder's practice is the connection of buyers and sellers for a flat fee, and the subsequent removal of the finder from the transaction.[74]

3. Active Solicitation of Securities Investors

A third factor implicating broker-dealership is active solicitation of securities investors.[75] The most decisive question is whether the finder

67. *See* Dominion 2000, *supra* note 57; Orcutt, *supra* note 2, at 907–08.

68. *See* Orcutt, *supra* note 2, at 906–07 (citing Dominion Resources, Inc., SEC No-Action Letter, 1985 WL 54428, at *1–3, *6–7 (Aug. 24, 1985) [hereinafter Dominion 1985]).

69. *See id.* at 906.

70. Dominion 2000, *supra* note 57.

71. *See* Orcutt, *supra* note 2, at 907.

72. Dominion 2000, *supra* note 57, at *3 (citing John R. Wirthlin, SEC No-Action Letter, 1999 WL 34898 (Jan. 19, 1999) (requiring registration for an alleged finder who solicited investors and received a contingency fee upon successful purchase); Davenport Mgmt., Inc., SEC No-Action Letter, 1993 WL 120436, at *11, *13 (Apr. 13, 1993) (requiring registration when a business broker receives transaction fees for negotiations); C & W Portfolio Mgmt., Inc., SEC No-Action Letter, 1989 WL 258821, at *1 (July 20, 1989) (requiring registration when a financial intermediary mediates a negotiation and receives success-based compensation)).

73. *See* HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW DATABASE § 23.2 (2007) (stating that "[a]ny person doing much more than simply introducing parties to a securities transaction to each other does so at his or her peril").

74. *Cf.* Angel Capital Elec. Network, SEC No-Action Letter, 1996 WL 636094 (Oct. 25, 1996) (granting no-action relief for an Internet matching service that merely connected entrepreneurs and investors).

75. *See* A.B.A. Report, *supra* note 3, at 979–80; Orcutt, *supra* note 2, at 914–15.

is contacting persons through preexisting relationships, which is usually permissible, or whether the finder is actively soliciting unknown third parties, which normally requires registration.[76] As for the extent of solicitation that invokes broker-dealership, the staff has not provided much guidance.[77] It is sufficient, then, to note that "[i]t is the content and extent of the solicitation, rather than the mode of communication, which will most likely determine the SEC's reaction to a finder's solicitation activities."[78]

4. Prior Involvement in or Discipline for Securities Activities

Finally, the SEC has examined the extent of a finder's previous dealings to determine whether the finder is actually a broker-dealer who is "engaged in the business of effecting transactions in securities."[79] In addition to weeding out de facto professionals, the staff has consistently expressed a desire to prevent past securities violators from using the finder's exception as a "back door" to remain in the industry and put investors at risk.[80] The *Rodney B. Price* no-action letter demonstrates this factor's true power.[81]

In *Price*, no-action relief was denied even though Price's only duties were locating broker-dealers to serve as potential underwriters or investors in private offerings.[82] Furthermore, Price would refrain from selling or advising the broker-dealers, and his fee was not based on the success of a transaction.[83] Although the requirement of registration was not explicitly tied to Price's previous dealings in securities, one-third of the letter was devoted to Price's prior securities activities and disciplinary history.[84]

76. *See* Orcutt, *supra* note 2, at 914–15.

77. *See* A.B.A. Report, *supra* note 3, at 979; *see, e.g.*, Thomas R. Vorbeck, SEC No-Action Letter, 1974 WL 8305, at *2 (March 24, 1974) (requiring registration because the company's plan "would entail *some* form of solicitation of business") (emphasis added).

78. A.B.A. Report, *supra* note 3, at 979–80.

79. 15 U.S.C. § 78c(a)(4)(A) (2006); *see also* A.B.A. Report, *supra* note 3, at 980–81 (stating that previous involvement in or discipline for securities activities increases the likelihood that a finder will be required to register as a broker-dealer); Orcutt, *supra* note 2, at 916–18 (explaining that a major factor used in determining whether a finder is a broker is the finder's involvement with and/or discipline in prior securities related activities).

80. *See* A.B.A. Report, *supra* note 3, at 980; Orcutt, *supra* note 2, at 916.

81. *See* A.B.A. Report, *supra* note 3, at 980; Orcutt, *supra* note 2, at 916.

82. Rodney B. Price, SEC No-Action Letter, 1982 WL 30390, at *1–2 (Nov. 11, 1982).

83. *Id.* at *2.

84. *Id.* at *1; *see also* A.B.A. Report, *supra* note 3, at 980 (noting that it was "fair to conclude that the staff's decision was motivated by the finder's previous securities activities"); Orcutt, *supra* note 2, at 917 (explaining that it was "logical to infer that the finder's prior activities in the securities industry

5. A Note on Common Law

It is debatable as to whether "the factors that must be present in order [to] receive a no-action letter are . . . identical to those that must exist for a court to conclude that a person is a finder rather than a broker or dealer."[85] Though many cases have evaluated what it means to affect transactions in securities[86] and a few have directly addressed the finder versus broker-dealer distinction,[87] the finder's battle to avoid broker-dealer registration is primarily waged through SEC no-action letter correspondence. Unfortunately, despite the increasing need for finders in the early stages of small business development and the countervailing risks posed by their employment, determining when a finder must register as a broker-dealer remains an inexact science. A strict reading of the staff's position dictates that a finder should—among other things—remove herself from the transaction as soon as the initial introduction is made.

III. STATE REGULATION OF FINANCIAL INTERMEDIARIES AND THE DAWN OF A DUAL REGULATORY SOCIETY

The SEC's failure to remedy the plight of small businesses has prompted several states to promulgate their own finder rules.[88] These rules are undoubtedly well-intentioned, but they will do little, if anything, to clarify the finder versus broker-dealer distinction and facilitate small business formation.[89] Because entrepreneurs and investors are normally subject to state and federal regulations, state registration schemes will only corral the rare securities offering that occurs purely intrastate.[90]

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and particularly his history of disciplinary actions were the primary motivation" for Price's no-action denial).

85. *See* BLOOMENTHAL & WOLFF, *supra* note 73, § 23.2 (explaining that "a court would not necessarily require compliance with each and every criterion of the SEC no-action letters in determining whether a person is a broker-dealer").

86. *See, e.g.*, SEC v. George, 426 F.3d 786, 797 (6th Cir. 2005); SEC v. Margolin, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,025, at 94,517 (S.D.N.Y. Sept. 30, 1992); *see also* Lipton, *supra* note 37, at 909–12 (examining case law construing the statutory definition of a broker).

87. Several decisions illustrate that some courts may be willing to consult SEC no-action letters for guidance. *See, e.g.*, Couldock & Bohan v. Société Generale Sec. Corp., 93 F. Supp. 2d 220, 228–30 (D. Conn. 2000); Cornhusker Energy Lexington, LLC v. Prospect St. Ventures, [2006 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,974, at 91,140 (D. Neb. Sept. 12, 2006).

88. *See* Ebaugh, *supra* note 7, at 21 (describing how the federal government's failure to address financial intermediaries has caused states to "rush to regulate this area").

89. *See* Jacobsen & Fay, *supra* note 9, at 42 ("[L]ittle can effectively be done at the state level until federal securities laws and regulations expand activities permitted by finders.").

90. *See* Ebaugh, *supra* note 7, at 22; *see also* ROBERT J. HAFT & MICHELE H. HUDSON, ANALYSIS OF

Instead of solving the funding gap, state registration schemes force finders to comply with conflicting federal and state regulations.[91] This new problem runs counter to the general trend of securities federalization and further highlights the need for preemptive federal legislation articulating the permissible role of finders in the small capital market.

A. State Registration for Finders

Michigan, Texas, and South Dakota have all recognized the need to monitor financial intermediaries through state registration.[92] While their mechanics are different, each state has tried to balance the goal of investor protection with relaxed registration procedures.[93] Michigan acted first in 1978 by defining a finder as "a person who, for consideration, participates in the offer to sell, sale, or purchase of securities or commodities by locating, introducing, or referring potential purchasers or sellers."[94] These finders are exempt from the burdensome process of broker-dealer registration, but they must still register with the state as investment advisers.[95]

Nearly twenty years later, Texas defined finders as persons who receive compensation for introducing issuers and accredited investors for the purpose of potential investment, but do not negotiate the terms of the investment or give advice regarding the merits of the transaction.[96] Unlike Michigan, Texas created a distinct category of finder registration complete with an explicit list of prohibited finder activities.[97] To comply with the Texas statute, finders must complete an application, pay a registration fee, make certain disclosures to prospective clients, limit the amount of information they disseminate concerning potential

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KEY SEC NO-ACTION LETTERS § 9:11 (2007) (referring to the intrastate offering exception to federal regulation as "illusory").

91. *See* Ebaugh, *supra* note 7, at 21.

92. *See* Posting of Jay Fishman to Jim Hamilton's World of Securities Regulation, http://jimhamiltonblog.com/2006_11_01_archive.html (Nov. 16, 2006, 10:12 EST).

93. *See, e.g.*, John R. Fahy, *The New Texas "Finder" Securities Broker Registration*, 41 TEX. J. BUS. L. 341, 341 (2006) (describing the new Texas finder rules as a "'light' version of broker-dealer registration").

94. MICH. COMP. LAWS § 451.801(i) (2002). The Act covered finders as part of its regulatory regime to monitor financial intermediaries who were not otherwise addressed by the registration scheme. *See* Hall, *supra* note 10.

95. *See* MICH. COMP. LAWS § 451.502 (2002); *see also* A.B.A. Report, *supra* note 3, at 966 n.7 (describing how the Michigan statute sets forth seven finder requirements for investment adviser registration).

96. 7 TEX. ADMIN. CODE § 115.1(a)(9) (2008).

97. *Id.* § 115.11(a).

investors, and maintain detailed records available to the Texas SEC for a five-year period.[98]

South Dakota followed Texas's lead by defining a finder as a "person who directly or indirectly locates, introduces, or refers any person to an issuer."[99] Among other things, finders are prohibited from giving investment advice, participating in negotiations, or soliciting new investors.[100] Notably, South Dakota finders can receive success-based compensation without destroying their exemption from broker-dealer registration so long as the compensation is disclosed prior to the transaction.[101] California appears next in line as the California Securities Commission solicited comments from the securities industry in late 2006 to determine how the state should regulate financial intermediaries.[102] Texas was purposely designed as a model for other states, and the recent surge of state activity suggests that states are tired of waiting for the federal government to act.[103] Instead of solving the finder's dilemma, however, widespread state regulation merely increases transaction costs for small business owners attempting to comply with applicable law.

B. The Problems Created by a Dual Regulatory System

The dual regulatory system, which simply refers to the overlap between federal and state securities regulation, places a particularly high burden of compliance on small issuers with limited resources.[104] While both federal and state regulators aim to protect investors and promote economic growth, competing philosophies have produced a complex set

98. *Id.*; *see also* Fahy, *supra* note 93, at 344–45 (listing the burdens imposed by Texas's finder registration).

99. S.D. ADMIN. R. § 20:08:03:17(3) (2008).

100. *Id.* § 20:08:03:17(3), :17(5).

101. *Id.* § 20:08:03:17(3)–(4).

102. Ca. Dep't of Corps., *Invitation for Comments on Administrative Regulation Under the Corporate Securities Law*, Sept. 13, 2006, *available at* http://www.corp.ca.gov/OLP/pdf/rm/3106notice.pdf.

103. *See* Ebaugh, *supra* note 7, at 21, 23 ("When it adopted the new rules, the Texas State Securities Board anticipated that they would be a model for other states to follow." Now, there is "[n]o question about it, states are in a rush to regulate this area."); *see also* Fahy, *supra* note 93, at 345 ("The Texas Finder Rule is the first such limited registration program in the United States and will act as a road map to other State Securities Administrators and the SEC should these regulators want to do something similar.").

104. *See* Douglas J. Dorsch, *The National Securities Market Improvement Act: How Improved Is the Securities Market?*, 36 DUQ. L. REV. 365, 392 (1998) (explaining that "[c]ompliance costs of $100,000 are more easily swallowed by an issuer of $7,000,000 of securities than by an issuer of only $250,000"); *see also* Michael W. Ott, *Delaware Strikes Back: Newcastle Partners and the Fight for State Corporate Autonomy*, 82 IND. L.J. 159, 164–65 (2007) (describing the dual regulatory system).

of rules that many find difficult to navigate.[105] In addition to federal requirements, issuers face varied obligations in different states,[106] and even if a common legal framework controlled, jurisdictions could interpret the framework differently.[107] The end result is a patchwork quilt of federal and multi-state regulation that—due to increased costs of compliance—deters the formation of many small to mid-sized businesses.[108]

If states continue to regulate financial intermediaries, the general issues presented by a dual regulatory system will be imposed on an area of the law which is already yearning for clarity. Even though Texas's decision to register finders has received some support from the business community, these reactions are short-sighted and misinformed.[109] Instead of protecting business interests, the new registration scheme exacerbates the funding gap by requiring small businesses to comply with not one, but two, sets of regulations.[110] Because the Texas statute conflicts with the federal broker-dealer requirements and—unlike Michigan and South Dakota—requires finders to register as a unique category of intermediary, finders may be in compliance with one set of rules while in violation of another.[111] For example, Texas requires the finder's introduction be to an accredited investor, while the Exchange Act contains no such qualification.[112] The federal rule, on the other hand, all but prohibits success-based compensation[113] while Texas and

105. *See* Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 890 (2006) [hereinafter Jones, *Does Federalism Matter?*].

106. *See* Kenneth I. Denos, *Blue and Gray Skies: The National Securities Markets Improvement Act of 1996 Makes the Case for Uniformity in State Securities Law*, 1997 UTAH L. REV. 101, 125 (1997) (noting that state securities laws are "a balkanized array of statutes with little resemblance to each other" that "were extremely imposing for multistate issuers").

107. *See id.* at 126 (explaining that interpretation of verbatim provisions of the Uniform Securities Act varied as much as the judges and regulators attempting to interpret them).

108. *See* Jones, *Does Federalism Matter?*, *supra* note 105, at 889–90 (explaining how the lack of uniformity caused corporations to complain "that the system was duplicative and wasteful because it required companies to contend with the costs and inconvenience of complying with federal securities laws as well [as] the laws of every state in which their securities traded"). Apple Computer's initial public offering is a good example of how varied state regulation can stunt capital growth. *See* Denos, *supra* note 106, at 112. In 1980, twenty states refused to approve the offering because it was "too risky," despite being underwritten by Morgan Stanley and achieving a very high appraisal. *See id.* As we now know, the offering was very lucrative for investors.

109. For a description of how the Texas finder's rule has received local support, see Hall, *supra* note 10. The initial optimism of the Houston business community, however, fails to consider that only intrastate dealings will be protected. *See* Ebaugh, *supra* note 7, at 22.

110. *See* Ebaugh, *supra* note 7, at 21, 23 ("[F]inders in Texas have the difficult task of reconciling the new finder rules with the federal securities laws.").

111. *See id.* at 22–23.

112. *See id.* at 21–22.

113. *See supra* Part II.B.1, *supra*.

South Dakota permit such compensation with the proper qualifications.[114] Purely intrastate securities transactions are not subject to federal regulations, but this narrow exception is incapable of providing a national solution to the capital formation problems of small businesses.[115]

Not only is a state-by-state approach insensitive to the finder's dilemma, but it also bucks the recent trend of securities federalization. In the past decade, Congress has abandoned its reliance on a dual regulatory system and launched a full-scale attack on the state securities field.[116] The Private Securities Litigation Reform Act of 1995 ("PSLRA"),[117] the National Securities Markets Improvement Act ("NSMIA"),[118] the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"),[119] and even Sarbanes-Oxley[120] are examples of federal preemption legislation divesting regulatory power from the states in a quest for uniformity.[121] While states retain the authority to require

114. *See* S.D. ADMIN R. 20:08:03:17 (2006); Ebaugh, *supra* note 7, at 22.

115. *See* Ebaugh, *supra* note 7, at 22; *see also* Lipton, *supra* note 37, at 943 (stating that the intrastate exception "is restrictively applied").

116. *See* A. Brooke Overby, *Our New Commercial Law Federalism*, 76 TEMP. L. REV. 297, 321 (2003) (describing the federal government's increased occupation of commercial law authority as "the phenomenon of creeping federalization"). For a particularly scathing critique of blue sky regulation, see J. Sinclair Armstrong, *The Blue Sky Laws*, 44 VA. L. REV. 713 (1958). The former SEC commissioner chastises blue sky laws for their "special meaning—a meaning full of complexities, surprises, unsuspected liabilities for transactions normal and usual—in short, a crazy-quilt of state regulations no longer significant or meaningful in purpose, and usually stultifying in effect, or just plain useless." *Id.* at 714–15.

117. Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in scattered sections of 15 U.S.C.). The PSLRA dramatically changed securities fraud claims by raising pleading standards and enacting lead plaintiff provisions for securities class actions. *See id*; *see also* Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 113 n.27 (2004) [hereinafter Jones, *Dynamic Federalism*].

118. Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified as amended in scattered sections of 15 U.S.C.). The NSMIA, which sought to balance investor protection with the need to streamline the securities registration process, prohibits states from regulating or requiring the registration of federally "covered securities," including those securities exempt from securities registration. *See* 15 U.S.C. § 77r(a) (2007); H.R. REP. NO. 104-622, at 16–17 (1996), *reprinted in* 1996 U.S.C.C.A.N. 3877, at 3878–79.

119. Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as 15 U.S.C. §§ 77(p)(c), 78(b) (2006)). The SLUSA preempts class action suits for securities fraud based on state law when the securities at issue are a "covered security." *See* Jones, *Dynamic Federalism*, *supra* note 117, at 113–14.

120. Pub. L. No. 107-204, 116 Stat. 746 (2002) (codified in scattered sections of 15 U.S.C.). In response to the Enron scandal, Sarbanes-Oxley imposed a greater level of federal oversight on corporate activity. *See generally* Valerie Watnick, *Whistleblower Protections Under the Sarbanes-Oxley Act: A Primer and a Critique*, 12 FORDHAM J. CORP. & FIN. L. 831, 831–32 (2007) (describing briefly the catalysts behind Sarbanes-Oxley).

121. *See* Jones, *Does Federalism Matter?*, *supra* note 105, at 894 (explaining that the preemption legislation "overturned a seventy-year tradition of federal deference to state authority in the securities arena"); Jones, *Dynamic Federalism*, *supra* note 117, at 113–14 (describing a series of federal attacks on state regulatory power in the securities field); *see also* Rutheford B. Campbell, Jr., *Blue Sky Laws*

notice filing and prosecute fraud within their jurisdiction,[122] the overwhelming trend is to facilitate capital formation by removing the burdens of multi-state compliance.[123] Applied to financial intermediaries, federal preemption makes good economic sense.[124] When the role of a finder is clearly defined and registration is centrally mandated by a common authority, regulation is powerful and efficient.[125] Moreover, transaction costs decrease and more small businesses are able to access the start-up capital currently eluding them.[126]

State registration of finders has a sound theoretical basis. State securities commissions exist to protect investors, after all, and finders are a powerful industry of unregulated individuals who are becoming increasingly prevalent in the early stages of capital formation.[127] Despite this, the efforts of Texas and its counterparts are doomed to fail.[128] As more and more states bow to local business interests, the body of multi-state regulation effectively dons layer after layer.[129] While investors may be better protected by such registration, it comes at too high a cost. For the small businesses already disadvantaged by the funding gap, the costs of ensuring compliance with the Exchange Act as well as the laws of fifty states are far too great to overcome.[130]

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and the Recent Congressional Preemption Failure, 22 J. CORP. L. 175, 196 (1997) (articulating the essence of preemption as the notion that "states no longer have the authority to enact rules requiring the registration or merit qualification of certain securities or with respect to certain transactions").

122. 15 U.S.C. § 77r(c) (2006). The preservation of state authority corresponds with the NSMIA's stated intent to permit state governments "to regulate small, regional, or intrastate securities offerings, and to bring actions pursuant to State laws and regulations prohibiting fraud and deceit, including broker-dealer sales practices abuses." *See* H.R. REP. NO. 104-622, at 16, *reprinted in* 1996 U.S.C.C.A.N. 3877, at 3878.

123. In his testimony before the Senate Committee on Banking, Housing, and Urban Affairs, SEC Chairman Arthur Levitt admitted, "[t]he current system of dual federal-state regulation is not the system that Congress—or the Commission—would create today if we were designing a new system." *See* S. REP. NO. 104-293 at *2, *available at* 1996 WL 367191.

124. *See* Orcutt, *supra* note 2, at 931 (proposing a federally-registered class of private placement finders which would largely preempt state regulation); *see also* Letter from Michael T. Williams, Williams Law Group, Pa., to SEC Advisory Committee on Smaller Public Companies (May 30, 2005), *available at* http://www.sec.gov/rules/other/265-23/mtwilliams6614.pdf (lobbying for federal preemption).

125. *See* Orcutt, *supra* note 2, at 931–32.

126. *See id.* (explaining that a tailored approach to finders could reduce private capital market problems "without including a multitude of additional (and costly) regulatory requirements").

127. *See supra* notes 15–21 and accompanying text.

128. *See* Jacobsen & Fay, *supra* note 9, at 42.

129. *See* Ebaugh, *supra* note 7, at 21.

130. *See id.* at 21, 23; *see also* Denos, *supra* note 106, at 106 (explaining that issuers "not only ha[ve] to comply with increasingly labyrinthine federal requirements, but also face[] fifty similarly worded statutes interpreted by state courts and regulators who viewed their duty to investors from a completely different perspective").

Congress has recognized that a dual regulatory system stifles economic growth in other contexts,[131] but it has consistently failed to apply a similar logic to financial intermediaries. Along with the murky definition of a lawful finder, a burgeoning dual regulatory system strengthens the argument for a definitive piece of federal finder's legislation. Without federal preemption, more states will legislate, more burdens will be imposed, and economic growth will continue to be hampered.[132]

IV. CONCLUSION

The proper government reaction to the inability of small businesses to obtain financing is to recognize the market's natural response of employing financial intermediaries and legitimize these activities through lightened registration.[133] This encourages capital formation by putting money into the hands of emerging small businesses and decreases the risk of investor fraud by bringing finders within the reach of the SEC's regulatory authority.[134] The present regulatory regime, however, does neither. Instead of embracing and defining the finder, the SEC has declined to draw a bright line between finders and broker-dealers.[135]

The proposal to legitimize the role of finders to facilitate capital formation is neither new nor particularly brilliant. Commentators and practitioners have suggested reform for years,[136] the Small Business Association and other advocate groups have repeatedly touted the merits of finder's reform,[137] and the American Bar Association ("ABA") has submitted an extensive study to the SEC identifying the crucial role finders play, the ineffective response of the current SEC regime, and the need for sweeping change.[138] Most proposals rightfully hinge on the creation of a federally-registered class of finders, either as a new

131. *See supra* notes 117–23 and accompanying text.

132. *See* Ebaugh, *supra* note 7, at 21, 22.

133. *See* A.B.A. Report, *supra* note 3, at 961–62; Connolly, *supra* note 1, at 706–07; Orcutt, *supra* note 2, at 938–41.

134. *See* Orcutt, *supra* note 2, at 931–32.

135. *See supra* Part II.B.

136. *See* Connolly, *supra* note 1, at 706–07; Orcutt, *supra* note 2, at 928–30; Makens, *supra* note 21, at 5; Letter from Michael T. Williams, Williams Law Group, Pa. to SEC Advisory Committee on Smaller Public Companies, *supra* note 124.

137. *See* SEC, Final Report of the Twenty-Third Annual SEC Government-Business Forum on Small Business Capital Formation, at 9–10 (Sep. 20, 2004), *available at* http://www sec.gov/info/smallbus/gbfor23.pdf (denoting finder's reform as the forum's number one recommendation).

138. *See generally* A.B.A. Report, *supra* note 3, at 968–70 (explaining the need for change).

category of financial intermediary or a subset of the broker-dealer.[139] Finders would be required to meet minimum standards, and registration burdens would be relaxed to create an environment where accredited finders are available to the small business market.[140]

Though finder's reform has been labeled a top priority and the SEC has spoken with representatives from the ABA,[141] obtaining new legislation has been and will likely continue to be an "uphill battle."[142] The National Association of Securities Dealers has lobbied hard to maintain the regulatory system's current reliance on broker-dealers, and some in the SEC fear that relaxing its registration requirements will leave investors vulnerable to market fraud.[143] But it is getting harder and harder to ignore market realities. The small business funding crisis has been well-documented by the financial and legal professions, and no one denies that small business development is essential to the growth of the American economy.[144] In addition to generating 60% to 80% of new jobs annually, small businesses represent 99.7% of all employer firms, employ approximately 50% of all private sector employees, pay more than 45% of total U.S. private payrolls, create more than 50% of nonfarm gross domestic products, and comprise 97% of all identified exporters.[145]

139. *Compare* Orcutt, *supra* note 2, at 930–31 (proposing a wholly distinct class of registered placement finders), *with* Connolly, *supra* note 1, at 724–25 (proposing a class of private investment fund private placement broker-dealers as a subcategory of the current registered broker-dealer community).

140. *See* A.B.A. Report, *supra* note 3, at 961–65; Connolly, *supra* note 1, at 725–28; Orcutt, *supra* note 1, at 930–45.

141. *See* Cohen et al., *supra* note 20 (reporting that the SEC Government-Business Forum on Small Business Capital Formation made finder's reform its highest priority recommendation); Linda C. Thomsen & John W. White, *The SEC Speaks in 2008: Division of Trading and Markets Outline*, 1645 PLI/Corp 91, 131 (2008) ("The [SEC] staff has met with members of the ABA Task Force, NASD staff, and NASAA representatives to discuss the ABA Task Force's recommendations and is actively considering the issues raised by the report.").

142. *See* Fink, *supra* note 1 (equating lobbying efforts for the SEC to lighten its registration burdens to an "uphill battle").

143. *See id.* (stating that if the SEC changed course, it would "run into stiff resistance from a lobby more influential than the CEO Council—the NASD polices broker-dealers for the SEC"). Fink also describes how recent fraud cases have sharpened the government's stance on strict broker-dealer requirements. *See id.*

144. *See, e.g.*, Orcutt, *supra* note 2, at 861 ("The continuous creation of new rapid-growth start-ups plays a substantial role in the success of the US economy."); SEC, Investor's Advocate, *supra* note 12 ("[T]he common interest of all Americans in a growing economy that produces jobs, improves our standard of living, and protects the value of our savings means that all of the SEC's actions must be taken with an eye toward promoting the capital formation that is necessary to sustain economic growth.").

145. U.S. Small Bus. Admin., Frequently Asked Questions, http://app1.sba.gov/faqs/faqIndexAll.cfm?areaid=24 (last visited Nov. 3, 2008); *see also* Orcutt, *supra* note 2, at 862 (summarizing statistics

Despite the undeniable necessity of small business formation to overall economic growth, policymakers are content to focus on more visible issues carrying a higher degree of political clout. Coupled with the market squeeze on small business capital, the SEC's repeated failures to define the lawful role of financial intermediaries in the capital-raising process is inexcusable. Small start-up businesses are consistently denied access to traditional capital markets, and many are left guessing as to whether their use of a finder will incur the prosecutorial wrath of the government. Now that states have grown impatient, the problems of a dual regulatory system have arisen in a fresh context. The fuzzy line between lawful finding and illegal broker-dealing, as well as the hurdles presented by state finder's registration, prevent our best and brightest from riding their innovations to the American dream and prolong instead, America's nightmare. Hopefully, the recent actions of the Texas and South Dakota legislatures will serve as a much needed wakeup call.

provided by the Small Business Administration).