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Law Alert

To: Firm Clients and Contacts

From: Niesar & Vestal LLP

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Re: **New Exemption from California Broker-Dealer Registration for Finders, Effective January 1, 2016**

On October 10, 2015, the Governor of California signed into law a bill that creates a statutory exemption for “finders” from the California securities broker-dealer registration requirement. This new law, Assembly Bill 667, which became effective on January 1, 2016, legalizes the payment of finder’s fees by an issuer of securities to a person (“finder”) not registered as a broker-dealer who introduces to the issuer accredited investors who purchase securities of the issuer, provided such finder complies with the requirements of new Section 25206.1 of the California Corporations Code.

This new exemption requires the following conditions to be satisfied:

1. The finder must be a natural person, not an entity.
2. The finder must only introduce “accredited investors” (as defined in Regulation D under the Securities Exchange Act of 1933) to the issuer of securities.
3. The transaction must involve the sale of securities by a California issuer to California investors only.

4. The size of the transaction must not exceed an aggregate purchase price of \$15 million.

5. The transaction must be qualified under the California securities laws or exempt from such qualification.

6. The finder must not (a) participate in negotiating any of the terms of the transaction, (b) advise any party to the transaction regarding the value of the securities or the advisability of purchasing or selling the securities, (c) conduct any due diligence for any party to the transaction, (d) sell any securities owned by the finder in the transaction, (e) receive possession or custody of funds in connection with the transaction, or (f) make any disclosure to a potential purchaser of securities other than the name, address and contact information of the issuer, the name, type, price and aggregate amount of securities offered in the transaction, and the issuer's industry, location and years in business.

7. In advance of taking any finder's fees, the finder must file a statement of information containing the finder's name and address with the California Department of Business Oversight ("DBO"), accompanied by a \$300 filing fee. Then the finder must file an annual renewal statement of information containing representations that the finder has complied with these exemption conditions, accompanied by a \$275 filing fee. Such annual renewal statements of information, along with all other records relating to the transaction, must be retained for five years.

8. The finder must obtain written agreements signed by the finder, the issuer and each person introduced by the finder, disclosing (a) the type and amount of compensation that has been or will be paid to the finder, (b) that the finder is not providing advice to the issuer or any person introduced to the issuer as to the value of the securities or advisability of purchasing or selling them, (c) whether the finder is also an owner of the securities being sold, (d) any conflict of interest in connection with the finder's activities, (e) that the parties have the right to pursue any available remedies for breach of the agreement, and (f) a representation by the person introduced by the finder that such person is an accredited investor and consents to the payment of the finder's fee. Such written agreements must be retained by the finder for a similar five year period.

This new law creates a fundamental change in California securities law, and also creates a conflict between California law and the current policy of the Securities and Exchange Commission ("SEC"), which considers almost all payments of finder's fees by an issuer of securities to a person not registered as a securities broker-dealer to be a violation of the federal securities laws. Therefore in order to rely on this new California exemption, issuers and finders should ensure that the securities transaction takes place wholly within California, with issuer, finders and investors all located in California, as the SEC tends to defer to state law in purely intrastate finder transactions.

Proponents of the new California law argue that it recognizes the widespread practice of payment of finder's fees to persons who are not registered as broker-dealers and the need to legalize this practice to promote capital formation in small businesses, given transaction-based compensation is often the only type of compensation a small business can afford to pay a finder, and given the previous penalties for payment of finder's fees to unregistered finders included rescission of sales of securities, which harms both issuers and investors. However, the new law is cumbersome, making it less likely to be used. There are a lot of conditions and filings imposed on finders who want to rely on this exemption; any finder who fails to satisfy all of the conditions is subject to the same penalties imposed on unregistered broker-dealers. Furthermore, the exemption is only available for new finders who haven't engaged in "finder" activities before, given the requirement that the finder file with the DBO an initial statement of information before it engages in any "finder activities". Therefore, this exemption is only available to new finders without experience, who are unlikely to be helpful to small business looking for investors. For these reasons this new law may not significantly contribute to the resolution of the "finder" problem in California.

This article is intended to provide a general summary and should not be construed as a legal opinion nor a complete legal analysis of the subject matter. To learn more about any matter discussed in this law alert, contact any Niesar & Vestal attorney.

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