

The Perils of Finder's Fees (Revisited)

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by Christopher L. Doerksen

Way back in 2017, one of [our earliest posts](#) discussed the legal and financial risks to both the issuer and the finder if an issuer pays a finder's fee in connection with a sale of securities in the United States, and the person receiving the fee is not a U.S. registered broker-dealer. In many cases, this type of fee violates U.S. securities laws. However, this continues to occur from time to time, especially in deals where U.S. counsel is not consulted prior to the closing. For a brief summary of the risks of paying this type of finder's fee, and an example of one issuer that declared bankruptcy as a result, read on.

The Securities and Exchange Commission (SEC) has taken the position that a person receiving a finder's fee with respect to a purchase of securities by a U.S. investor will, in many cases, be treated as having acted as a "broker" within the meaning of federal securities laws.^[1] In those cases, the unregistered finder has violated the federal securities laws. Similarly, the issuer may have violated the federal securities laws (under an agency theory, or otherwise) by having paid such fee. In many states, state regulators take similar positions under applicable state law. The filing of post-closing notices of sale with the SEC and the states disclosing such a fee may result in federal and state regulatory enforcement actions to seek injunctions, monetary penalties or criminal sanctions against the issuer and/or finder. Perhaps more importantly, the payment of the fee may provide the relevant investor(s) with a right to rescind their investment, and create uncertainty about whether and the extent to which such rights should be reflected in the issuer's financial statements. Such disclosures may adversely affect the issuer's ability to raise funds, and may further increase the risk of such a rescission claim or regulatory enforcement action.

One real life example is the case of Neogenix Oncology Inc. In a series of financings, Neogenix paid finder's fees to unregistered persons. In Q4 2011, the SEC initiated a regulatory inquiry. Neogenix was soon dealing both with the SEC and its auditors. Neogenix disclosed that its auditors were unwilling to review or audit Neogenix's financial statements because of their uncertainty as to how to reflect any possible rescission rights. Without that review and audit, Neogenix was unable to timely complete and file

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with the SEC its quarterly report for Q3 2011, its annual report for FY 2011, and its quarterly reports for 2012. As a result, Neogenix was also unable to raise additional funds. Several directors and employees departed, and in July 2012 Neogenix filed for bankruptcy protection under Chapter 11.

[1] This blog post does not address the exemption available under federal securities law to “M&A brokers” with respect to certain transactions involving a transfer of control of a private company.