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NEWSLETTER

CALIFORNIA LAW LEGALIZES PAYMENT OF FINDER'S FEES FOR SECURITIES OFFERINGS

Effective January 1, 2016, California legalized the payment of finder's fees to a person who introduces accredited investors who purchase securities of a California company and who complies with the requirements of Section 25206.1 of the California Corporations Code.

The new California law was proposed by the Business Law Section of the California State Bar in 2012 for the purpose of legalizing what the Business Law Section acknowledged was already a widespread practice of the payment of finder's fees by businesses seeking to raise capital. The Business Law Section noted that often the only way a small business could raise capital was by paying finders a fee based on the amount of capital raised.

The new California law has numerous requirements on the issuer and the finder:

1. the finder must be a natural person, not an entity;
2. the transaction must be a sale of securities by an issuer of the securities in California;
3. the size of the entire transaction (not just the portion raised by a particular finder) for which the finder is engaged must not exceed a purchase price of \$15 million;
4. the finder must not: (a) participate in negotiating any of the terms of the transaction; (b) advise any party 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 that are owned directly or indirectly by the finder; (e) receive possession or custody of any funds in the transaction; (f) participate in the transaction unless it is qualified by permit or exempt from qualification under California law; (g) make any disclosure to any potential purchaser of securities other than the name and contact information of the issuer, the name, type, price and aggregate amount of the securities offered, and the issuer's industry, location and years in business;
5. in advance of taking a finder's fee, the finder must file a statement of information with the California Bureau of Business Oversight, and pay a \$300 filing fee;
6. the finder must obtain a written agreement signed by the finder, the issuer and the person introduced by the finder, disclosing: (a) the type and amount of compensation that has been or will be paid to the finder and the conditions for payment of that compensation; (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 actual and potential 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 investor that the investor is an "accredited investor" as defined in SEC Regulation D and consents to the payment of the finder's fee.

The new California law is contrary to the current policy of the Securities and Exchange Commission, which considers payments of finder's fees to persons not registered as securities broker-dealers as violations of the Securities Exchange Act of 1934. For this reason, the California law will be applicable only to a California corporation that is issuing securities to accredited California residents, and any transaction conducted outside of California may result in penalties to the issuer and the finder.

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