

OF INTEREST

Update On Private Funds and Broker-Dealer Registration

July 16, 2013

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We sent an alert a few months ago about the Staff of the Securities and Exchange Commission (the “SEC”) sounding the drumbeat regarding the need for private fund managers to consider their potential obligation to register as broker-dealers under the Securities Exchange Act of 1934. In April, David W. Blass, the Chief Counsel in the SEC’s Division of Trading and Markets, spoke about this issue and reiterated the Staff’s view that a central factor in determining whether a private fund manager needs to register is the manager’s receipt of transaction-based compensation.¹ As Mr. Blass said, “receipt of transaction-based compensation is a hallmark of being a broker.” He indicated that the determination of whether the personnel of private fund managers should register as broker-dealers is a fact-intensive inquiry.

¹ David W. Blass, A Few Observations in the Private Fund Space, Address Before the Trading and Markets Subcommittee of the American Bar Association, Washington, D.C. (Apr. 5, 2013), *available at* <http://www.sec.gov/news/speech/2013/spch040513dwg.htm>.

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Since that alert, an important event has transpired. It appears that the SEC has decided not to appeal a federal district court ruling that a capital raiser for a company was not acting as a broker-dealer even though he received transaction-related compensation.² In this case, Kevin Kramer had developed an understanding with a company that the company would pay him for introducing potential investors if the investors decided to invest.³ The SEC alleged that Mr. Kramer had acted as an unregistered broker-dealer in this capacity. The court agreed that Mr. Kramer had received transaction-based compensation, but ruled that this fact alone did not make him a broker-dealer. The court found that the SEC had presented no evidence that Kramer had participated in the negotiations for investing, discussed the details of a proposed transaction, analyzed the financial status of the company to be invested, or promoted an investment in the company. The court concluded that Kramer's minimal involvement in the transactions was not enough to make him a broker-dealer.

The media has reported that the date for the SEC to appeal the decision has passed without the SEC's submission of an appeal. It is curious that the SEC chose not to appeal the decision given its past pronouncements that receiving transaction-based compensation for finding investors for a company's securities is enough to be deemed broker-dealer activity. This is particularly interesting given the SEC's recent *Ranieri*⁴ enforcement action, which, in addition to highlighting the limited scope of the so-called "finder's" exemption, further reinforced the significance of transaction-based compensation in the eyes of the SEC. While the *Kramer* decision is encouraging in that a court has rejected the SEC's persistent stance that the receipt of transaction-based compensation alone may be enough to cause a person to be considered a broker-dealer by the SEC, we caution that clients should not rely on a single decision from a district court in Florida. Although there has not been an SEC statement on its decision not to appeal the *Kramer* decision, given the statements that the SEC has been making on the broker-dealer registration issue over the past year, it appears that the SEC has not adopted the reasoning of the *Kramer* decision.

As we noted in our last alert on this topic, the issue of broker-dealer registration in the private fund area appears to be an evolving one. We read the SEC Staff's recent comments as suggesting that the Staff might draft a rule or interpretive guidance on private fund fundraising activity and the receipt of transaction-based fees by private fund managers. Ideally, any guidance by the SEC would also address the *Kramer* decision and the agency's views on that case. In the meantime, given the highly fact-intensive nature of the issue, we suggest that private funds consult with counsel before taking any action in this area, in order to take these developments into consideration when addressing specific circumstances. Please contact us about any questions you might have regarding these issues.

² *SEC v. Kramer*, 778 F. Supp. 2d (M.D. Fla. 2011).

³ Kevin Kramer is **not** related to Howard Kramer, one of the authors of this alert.

⁴ *Ranieri Partners LLC*, Exchange Act Release No. 69091 (Mar. 8, 2013).

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July 16, 2013

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