Private Company M&A Brokers Relief from SEC Registration

January 13, 2015, 12:00PM – 1:00PM EST

Presenter: Hillel T. Cohn

1. Presentation


3. 113th Congress: S. 1923: Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014

4. NASAA Comment Letter RE: S. 1923

5. All Points Traders, Inc. v. Barrington Associates (California Appellate Court 1989)

Private Company M&A Brokers
Relief from SEC Registration

January, 2015
Hillel Cohn
Statutory Context

• Definition of Broker…”any person engaged in the business of effecting transactions in securities for the account of others.”
  • Section 3(a)(4) of the Securities Exchange Act of 1934 (the “Exchange Act”)
• Brokers engaged in inter-state commerce must register with the SEC
  • Section 15(a) of the Exchange Act
• Most states also require registration if the broker has an office in the state or engages in business in the state
• SEC interprets “effecting transactions” to include involvement in any of the key aspects of a securities transaction, including solicitation, negotiation and execution
• Applied to M&A Brokers, this interpretation would require registration if the broker solicits or assists in the negotiation of a transaction which is structured as a merger or stock purchase
The Problem

- The regulatory regime developed for broker-dealers is designed for full-service retail brokers and investment banks engaged in a broad array of capital markets activity.
- Many of the regulatory requirements are of little or no relevance to M&A boutiques.
- Until this year, all broker-dealers were required to comply with the same set of regulatory requirements.
- The SEC provided limited no-action relief for business brokers who undertook to sell companies through an asset sale structure.
- But this relief was inadequate given the reality that many sales of private companies are structured as stock deals.
- Moreover, often don’t know until well into the deal if it will be a stock sale or an asset sale.
Legislative Proposals

- A number of legislative proposals have been introduced to create an exemption for M&A Brokers.
- At the end of 2013, the House passed a bill that would exempt M&A Brokers who only advise on transactions for private companies which meet at least one of the following criteria:
  - Less than $25 million of EBITDA
  - Less than $250 million of gross revenues
- That bill is now pending in the Senate as S. 1923.
- S. 1923 has come under criticism from NASAA and others for elimination of a bad boy disqualifier.
The No-Action Letter

- SEC issues no-action letter on January 31, 2014

- Broad ruling: M&A Brokers who advise solely on private company M&A transactions need not register with the SEC

- Consistent with the Blass speech in April 2013 noting that the SEC was mindful that certain broker-dealers who engaged in limited lines of business did not necessarily need to be subject to the full panoply of broker-dealer regulation
Who Qualifies for Relief?

- Who qualifies for the relief?
  - Broker must limit business to advising on private company transactions
  - Broker may not engage in any public offering of securities
  - Broker may not organize a buy-out group
    - This limitation may be a stumbling block for some intermediaries
  - Broker may not provide financing (but may assist buyer in finding financing)
  - Broker may not bind the principals
  - Broker may never have possession of client funds or securities
  - Bad boys need not apply
    - Neither the broker nor any of its officers, directors or employees have been barred or suspended by SEC, any SRO or any state
Covered Transactions

• What transactions qualify for the relief?

  • Transactions involving private companies
    • Company is not SEC reporting
    • No other limit on size of private company
    • Shell companies ineligible

  • Mergers, acquisitions, combinations, etc. resulting in a transfer of control
    • Buyers acquire power to dispose of or vote at least 25%

  • Party obtaining control is not a passive investor…must actively run the company
    • This requirement may effectively override the 25% standard
Covered Conduct

• What conduct may the private company M&A Broker undertake?
  • Provide financial advice
  • Solicit buyers
  • Participate in negotiations
  • Help structure the transaction
  • Provide valuation and/or fairness opinion
  • Assist in arranging financing from unaffiliated sources
Limitations of the Relief

• No-action letter relieves private company M&A Brokers from SEC and FINRA requirements

• No relief from state registration requirements

• State requirements vary
  • Many states exempt brokers who have no place of business in the state and who limit their in-state contacts to institutional investors and a specified number of non-institutional investors in any 12 month period
  • California specifically exempts M&A specialists
    • But California requires “business brokers” to register as real estate brokers unless they are licensed securities brokers
  • Other states (Ohio) have no relevant exemption

• Not yet clear how states will respond
  • NASAA has indicated support for the concept of reducing the regulatory burden on private company M&A Brokers
Next Steps

- The lack of a parallel exemption at the state level severely restricts the utility of the SEC no-action letter
  - Most states are not prepared to act as the principal regulator of broker-dealers
  - Little benefit in shifting to state registration
- States recognize this and are working on a response
- Per recent discussions with NASAA, a proposal will likely be issued in the first half of 2015
  - Likely to include tough bad boy provision
- Pending further action by the states, best to maintain current status and evaluate potential benefits of de-registration with the SEC if and when parallel relief is provided at the state level
Faith Colish, Esq., Carter Ledyard & Milburn LLP  
Martin A. Hewitt, Esq., Attorney at Law  
Eden L. Rohrer, Esq., Crowell & Moring, LLP  
Linda Lerner, Esq., Crowell & Moring, LLP  
Ethan L. Silver, Esq., Carter Ledyard & Milburn LLP  
Stacy E. Nathanson, Esq., Crowell & Moring, LLP  

RE: M&A Brokers  

January 31, 2014  
[Revised: February 4, 2014]  

Faith Colish, Esq., Carter Ledyard & Milburn LLP  
Martin A. Hewitt, Esq., Attorney at Law  
Eden L. Rohrer, Esq., Crowell & Moring, LLP  
Linda Lerner, Esq., Crowell & Moring, LLP  
Ethan L. Silver, Esq., Carter Ledyard & Milburn LLP  
Stacy E. Nathanson, Esq., Crowell & Moring, LLP  

RE: M&A Brokers  

Dear Ms. Colish, Mr. Hewitt, Ms. Rohrer, Ms. Lerner, Mr. Silver and Ms. Nathanson:  

In your letter dated January 31, 2014, you requested assurances that the Division of Trading and Markets would not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 (“Exchange Act”) if an “M&A Broker” (as that term is defined below) were to engage in the activities described in your letter in connection with the purchase or sale of a privately-held company without registering as a broker-dealer pursuant to Section 15(b) of the Exchange Act.  

Based on the facts and representations in your request (in particular those described below), and without necessarily agreeing with your analysis, the Division would not recommend enforcement action to the Commission under Section 15(a) of the Exchange Act if an M&A Broker were to effect securities transactions in connection with the transfer of ownership of a privately-held company under the terms and conditions described in your letter without registering as a broker-dealer pursuant to Section 15(b) of the Exchange Act. Different facts and circumstances may cause us to reach a different conclusion. The relief in this letter is limited solely to the transactions described in your letter.  

An “M&A Broker” for purposes of this letter is a person engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company (as defined below) through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the company, to a buyer that will actively operate the company or
the business conducted with the assets of the company. A buyer could actively operate the company through the power to elect executive officers and approve the annual budget or by service as an executive or other executive manager, among other things.

A “privately-held company” for purposes of this letter is a company that does not have any class of securities registered, or required to be registered, with the Commission under Section 12 of the Exchange Act, or with respect to which the company files, or is required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act. Any privately-held company that is the subject of this letter would be an operating company that is a going concern and not a “shell” company.¹

You requested relief on behalf of M&A Brokers that facilitate mergers, acquisitions, business sales, and business combinations (together, “M&A Transactions”) between sellers and buyers of privately-held companies, without regard to the size of the privately-held companies. Your letter contemplates that the M&A Broker may advertise a privately-held company for sale with information such as the description of the business, general location, and price range.

In issuing this letter, we note in particular your representations that:

1. The M&A Broker will not have the ability to bind a party to an M&A Transaction.

2. An M&A Broker will not directly, or indirectly through any of its affiliates, provide financing for an M&A Transaction. An M&A Broker that assists purchasers to obtain financing from unaffiliated third parties must comply with all applicable legal requirements, including, as applicable, Regulation T (12 CFR 220 et seq.), and must disclose any compensation in writing to the client.

3. Under no circumstances will an M&A Broker have custody, control, or possession of or otherwise handle funds or securities issued or exchanged in connection with an M&A Transaction or other securities transaction for the account of others.

4. No M&A Transaction will involve a public offering. Any offering or sale of securities will be conducted in compliance with an applicable exemption from registration under the Securities Act of 1933 (“Securities Act”). No party to any M&A Transaction will be a shell company, other than a business combination related shell company.²

¹ A “shell” company is a company that: (1) has no or nominal operations; and (2) has: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets. In this context, a “going concern” need not be profitable, and could even be emerging from bankruptcy, so long as it has actually been conducting business, including soliciting or effecting business transactions or engaging in research and development activities.

² The term “business combination related shell company” means a shell company (as defined in Securities Act Rule 405) that is: (1) formed by an entity that is not a shell company solely for the purpose
5. To the extent an M&A Broker represents both buyers and sellers, it will provide clear written disclosure as to the parties it represents and obtain written consent from both parties to the joint representation.

6. An M&A Broker will facilitate an M&A Transaction with a group of buyers only if the group is formed without the assistance of the M&A Broker.

7. The buyer, or group of buyers, in any M&A Transaction will, upon completion of the M&A Transaction, control and actively operate the company or the business conducted with the assets of the business. A buyer, or group of buyers collectively, would have the necessary control if it has the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. The necessary control will be presumed to exist if, upon completion of the transaction, the buyer or group of buyers has the right to vote 25% or more of a class of voting securities; has the power to sell or direct the sale of 25% or more of a class of voting securities; or in the case of a partnership or limited liability company, has the right to receive upon dissolution or has contributed 25% or more of the capital. In addition, the buyer, or group of buyers, must actively operate the company or the business conducted with the assets of the company.

8. No M&A Transaction will result in the transfer of interests to a passive buyer or group of passive buyers.

9. Any securities received by the buyer or M&A Broker in an M&A Transaction will be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act of 1933 because the securities would have been issued in a transaction not involving a public offering.

10. The M&A Broker (and, if the M&A Broker is an entity, each officer, director or employee of the M&A Broker): (i) has not been barred from association with a broker-dealer by the Commission, any state or any self-regulatory organization; and (ii) is not suspended from association with a broker-dealer. This staff position is limited to the registration requirements of Section 15(a) of the Exchange Act. Other provisions of the federal securities laws, including but not limited to the anti-fraud provisions, continue to apply. The staff expresses no view with respect to any other questions raised by an M&A Transaction, including, but not limited to, the applicability of other federal or state laws to the operation of M&A Brokers.
If you have any questions regarding this letter, please call Joseph Furey, Joanne Rutkowski, Darren Vieira, or me at (202) 551-5550.

Sincerely,

David W. Blass
Chief Counsel and Associate Director
Dear Mr. Blass:

We are writing to you on our own behalf as attorneys who have represented clients in connection with mergers and acquisitions and similar business brokerage transactions. We respectfully request assurance that the staff of the Division of Trading and Markets (the “Staff”) of the Securities and Exchange Commission (the “Commission”) will not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) if a person were to engage in the activities described in this letter in connection with the purchase or sale of a privately-held company without registering as a broker-dealer pursuant to Section 15(b) of the Exchange Act.

**Background**

A long-standing issue in the area of broker-dealer regulation concerns the treatment of persons who help to facilitate the sale of operating businesses. For many years there was an open question as to whether a sale of all of or a controlling interest in a business was a securities
transaction or effectively a sale of the assets of the company (and not a securities transaction).\(^1\) In *Landreth Timber Co. v. Landreth*\(^2\) (involving the transfer of 100% of the stock of a closely held corporation), and a companion case, *Gould v. Reufenacht*\(^3\) (involving the transfer of 50% of the stock of a closely held corporation), the U.S. Supreme Court answered the question definitively. The Court held that this type of transaction involves a sale of “securities” within the meaning of the Securities Act of 1933 (the “Securities Act”) and the Exchange Act.

As a result, a person that is in the business of effecting the sale of operating businesses through the sale of securities generally could be viewed as falling within the meaning of the term “broker” as defined in Section 3(a)(4) of the Exchange Act. Absent an exception or exemption, that person would be required to register as a broker-dealer pursuant to Section 15(a) of that Act and become a member of a self-regulatory organization.\(^4\) If, however, the transaction were structured as an asset sale and did not involve the sale of securities, a person could engage in the same types of “brokering” activities without registering as a broker-dealer.

This is an anomalous result, in that the transaction structure is generally determined based on accounting or tax considerations, rather than on the applicability of the federal securities laws to the transaction or the broker. Further, mergers, acquisitions, business sales, and business combinations (together, “M&A Transactions”) between sellers and buyers of privately owned companies are qualitatively different in virtually every respect from traditional retail or institutional brokerage transactions. Most notably, the active role of the buyer and seller in an M&A Transaction distinguishes these transactions from the purchase and sale of securities by retail and other investors for passive investment purposes, which is appropriately effected through the services of a registered broker-dealer.

- A buyer that seeks to acquire control and operate all or part of a seller’s business will want to conduct due diligence, often with the assistance of legal counsel, accountants,

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\(^{3}\) 471 U.S. 701 (1985).

\(^{4}\) A person that is in the business of effecting the sale of operating businesses through the sale of securities would need to be a member of a national securities association. See Exchange Act Sections 15(b)(8) and (9). At present, the only registered national securities association is the Financial Industry Regulatory Authority (“FINRA”). If the person in question is an individual, he or she could become registered as a representative of a FINRA member, provided that the FINRA member was engaged to effect the sale.
and other business consultants. Depending on the size of the transaction, a buyer may engage the services of an intermediary in connection with due diligence, valuation issues, structuring concerns and various business-related issues.

- A seller, in turn, is also actively involved. The seller of a business may need to provide access to both current and historical business-related information.\(^5\) An intermediary also may assist a seller with, among other things, advice about potential buyers, valuation issues, due diligence, structuring concerns and various business-related issues.

The particular services to be provided by an intermediary will differ depending on the facts and circumstances of the particular M&A Transaction. There is no “one-size-fits-all” M&A Transaction template. Rather, there are a number of variables that can affect the structure, timing and ultimate outcome of an M&A Transaction. The terms and conditions of these transactions are typically subject to negotiation between the seller and buyer, and memorialized in a series of transaction-related agreements that may involve legal counsel, accountants, commercial bankers, and other business consultants for either or both of the parties.

Intermediaries in M&A Transactions can perform a valuable function in preserving and creating jobs, and maximizing shareholder value. They can assist buyers by, among other things, bringing potential acquisitions to their attention. They can benefit sellers as well by exposing their businesses to a wider range of potential purchasers than the seller itself might be able to identify. Such exposure can result in competing bids, thus assisting the seller to maximize the sale price and perhaps shortening the time to conclude a sale.

As the ABA Task Force on Private Placement Broker- Dealers noted in its 2005 Report, broker-dealer registration imposes significant costs, as well as a regulatory model that is not “right-sized” to accommodate the particular role played by these intermediaries.\(^6\) The registration process is lengthy, and costs and fees, together with start-up and first-year expenses, including legal, accounting and operating costs, can equal several hundred thousand dollars. Persons effecting only one or several transactions a year simply cannot bear this financial burden. These firms do not hold customer funds or securities, and many merely introduce the parties to one other and transmit documents between the parties, not participating in structuring or negotiating these transactions or otherwise advising the parties. Both buyers and sellers in this type of transaction are typically represented by legal counsel who can assist with due diligence, draft the transaction documentation and advise their clients on structure, tax considerations and

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\(^5\) This information and related documentation is commonly prepared for management or tax purposes, rather than for presentation to prospective buyers.

\(^6\) This and other concerns related to unregistered “finders” were discussed at length in the American Bar Association Report and Recommendation of the Task Force on Private Placement Broker-Dealers, dated June 20, 2005.
contractual provisions, and there are remedies, both contractual and by operation of law, that are available to the parties to these types of transactions.

For the reasons explained above, efforts should be made to expand, not contract, the number of persons who can provide this service. We believe that the active roles and business objectives of each seller and buyer, together with the nature of the underlying transactions and the availability of remedies, both contractual and by operation of law, provide significant protections for the parties, and so form a basis for relief for the intermediaries from the requirements and costs associated with registration as a broker-dealer under Section 15(b) of the Exchange Act. Moreover, we note that state securities and other laws regulate various aspects of these activities.

Limitations on the Applicability of Relief under Current No-Action Letters

The Staff has issued two letters providing limited relief in this area. *Country Business, Inc.* (SEC No-Action Letter, November 8, 2006) ("Country Business"), and *International Business Exchange Corporation* (SEC No-Action Letter, December 12, 1986) (individually, a “Letter”, and collectively, the “Letters”). In *Country Business*, the Staff agreed not to recommend enforcement action under Section 15(a) if Country Business engaged in certain limited activities without registering as a broker-dealer. The Staff based its relief on representations that:

1. if a decision is made to effect the transaction by a sale of securities, Country Business would have a limited role in negotiations between the seller and potential purchasers or their representatives and would not have the power to bind either party in the transaction;

2. the business represented by Country Business would be a going concern and not a “shell” organization;

3. the selling company satisfies the size standards for a “small business” pursuant to the Small Business Size Regulations issued by the U.S. Small Business Administration;

4. only assets would be advertised or otherwise offered for sale by Country Business;

5. if the transaction is effected by means of securities, it would be a conveyance of 100% of the equity securities to a single purchaser or group of purchasers formed without the assistance of Country Business;

The states will still have all the registration and enforcement tools presently available to them, and we note that historically there has been little need for state regulatory intervention in these transactions. In addition, we are seeking relief from registration under Section 15 only. The other provisions of the federal securities laws, including the anti-fraud provisions, will of course continue to apply.
(6) Country Business would not advise the two parties whether to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold (other than by valuing the assets of the business as a going concern);

(7) the compensation of Country Business would be determined prior to the decision on how to effect the sale of the business, would be a fixed fee, hourly fee, a commission, or a combination thereof, based upon the consideration received by the seller, regardless of the means used to effect the transaction and would not vary according to the form of conveyance (i.e., securities rather than assets);

(8) the compensation of Country Business would be received in the form and at the times described below; and

(9) Country Business would not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.

Significantly, Country Business permits the intermediary to receive transaction-based compensation. Under the Letter, the compensation must be determined prior to the decision on how to effect the sale of the business and must be payable in cash. Additionally, the parties may agree, prior to the decision on how to effect the sale of the business, to defer the intermediary's compensation to the same extent that the consideration paid by the purchaser to the seller is deferred (i.e., if consideration to the seller from the purchaser is paid in part upon, and in part after, closing, the intermediary could likewise receive its compensation in part upon, and in part after, closing).

Country Business imposed significant restrictions on the role, and hence the utility, of the intermediary. Only the assets of the business may be listed for sale. The intermediary cannot advertise or otherwise promote the sale of securities. Any decision to effect the transfer of a business by means of a securities sale must be made solely by the purchaser and seller without the recommendation of the intermediary. If a decision is made to effect the transaction by a sale of securities, the intermediary must limit its role to the following:

(1) transmitting documents between the parties;

(2) valuing the assets of the business as a going concern;

(3) providing the seller with administrative support; and

(4) assisting the seller with preparation of financial statements.

An intermediary seeking to rely on Country Business also cannot otherwise be involved in negotiating the terms of the sale between or among the parties, or offer advice to either the purchaser or seller about the value of the securities, other than valuing the assets of the business as a going concern. Although the intermediary may prepare a detailed description of the seller's
company based on information supplied by the seller, including historical financial data and publicly available information, the intermediary must apprise potential purchasers that it makes no representations about the accuracy of the information provided.

*International Business Exchange Corporation*, which was issued 20 years earlier, differed from *Country Business* in two significant ways. First, it did not include any reference to the size of the business being sold but excluded only entities that are not closely held. Second, *International Business Exchange Corporation* did not require that a compensation determination be made prior to determining the structure of the transaction, but only that compensation not vary by the type of transaction.\(^8\)

A person seeking to rely on the Letters cannot engage in negotiations on behalf of a client, advise the client whether to issue securities, or assess the value of any securities sold. Transactions are limited to the sale of 100% of the equity of the company to be acquired. Moreover, the Letters leave unclear whether alternative fee arrangements are permissible in connection with the sale of larger businesses.\(^9\) Finally, transaction size limits and the seemingly arbitrary distinction between asset sales and securities transactions may have unintended consequences. Among other things:

- The limitations on the size of the transaction may preclude certain intermediaries from participating in transactions that may impact the greatest number of employees and potentially have the greatest economic impact, as well as in the large number of transactions that may fall short of the 100% equity requirement but nonetheless involve a change in control. Although parties to larger transactions may wish to select from the wide array of services offered by sophisticated investment bankers that are registered broker-dealers, we do not believe that buyers or sellers in large transactions should be unduly restricted in their choice of an intermediary.

- An intermediary may seek to limit its participation to transactions involving the sale of assets, rather than securities transactions, to avoid violation of broker registration requirements. However, a securities transaction may be of greater benefit to the buyer

\(^8\) Although *Country Business* is silent in this regard, it is generally viewed as modifying *International Business Exchange Corporation* in those respects.

\(^9\) The Letters have created ambiguity about permissible compensation arrangements. *International Business Exchange Corporation* permits the receipt of commissions, but it does not explicitly permit alternative fee arrangements like hourly fees or fixed fees. In contrast, *Country Business* explicitly permits a range of fee arrangements, including commissions and alternative fee arrangements, but only in the context of the sale of small businesses.
and/or seller for tax reasons, or may permit a higher sales price than if the transaction does not involve the transfer of securities. Even when a transaction is structured as a sale of assets, the issuance of promissory notes in connection with the transaction may, depending on the terms of those notes and the holders, result in the unintended consequence of a securities transaction having been effected. It is important for an intermediary to be able to provide assistance as needed in these transactions, regardless of how the principals determine to structure the transaction.

Request for Relief

As noted above, we request assurance that the Staff would not recommend enforcement action to the Commission under Section 15(a) of the Exchange Act if an M&A Broker (as defined below) were to effect securities transactions in connection with the transfer of ownership of a privately held company under the terms and conditions described in this letter.

For purposes of the relief we request, an “M&A Broker” is:

a broker engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company (as defined below) through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the company, to a buyer that will actively operate the company or the business conducted with the assets of the company.10

A company is a “privately-held company” if it does not have any class of securities registered, or required to be registered, with the Commission under Section 12 of the Exchange Act or with respect to which the company files, and is not required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act.

Any privately-held company that is the subject of an M&A Transaction will be an operating company that is a going concern and not a “shell” company.11

10 An M&A Broker may be involved as well in the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, only assets of the company. Absent a securities transaction, those activities would not require broker-dealer registration.

11 A “shell” company is one that: (1) has no or nominal operations; and (2) has: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets. See Securities Act Rule 405(i). In this context, a “going concern” need not be profitable, and could even be emerging from bankruptcy, so long as it has actually been conducting

(continued...
Based on the discussion above, the requested relief would:

1. Permit the M&A Broker to represent either the buyer or the seller of the business, or both of them, so long as the M&A Broker provides clear written disclosure to both parties as to which parties it represents and has obtained written consent from both parties to any joint representation.

2. Permit an M&A Broker to facilitate an M&A Transaction with a buyer or a group of buyers formed without the assistance of the M&A Broker that, upon completion of the M&A Transaction, will control the company or the business conducted with the assets of the company. A buyer, or group of buyers collectively, would have the necessary control if it has the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. The necessary control will be presumed to exist if, upon completion of the transaction, the buyer or group of buyers has the right to vote 25% or more of a class of voting securities, has the power to sell or direct the sale of 25% or more of a class of voting securities, or, in the case of a partnership or limited liability company, has the right to receive upon dissolution or has contributed 25% or more of the capital. The buyer, or group of buyers, must actively operate the company or the business conducted with the assets of the company.

3. Permit an M&A Broker to facilitate an M&A Transaction involving the purchase or sale of a privately-held company (as defined herein), without regard to the size of the privately-held company.

4. Permit the M&A Broker to participate in M&A Transactions and allow the M&A Broker to advertise a company for sale with information such as the description of the business, general location, and price range.

5. Permit the M&A Broker to advise the parties to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold.

(continued...)

business, including soliciting or effecting business transactions or engaging in research and development activities.

12 Such role could be fulfilled through the power to elect executive officers and approve the annual budget, or by service as an executive or other executive manager.
6. Permit the M&A Broker to receive transaction based or other compensation, as agreed by the parties, in connection with an M&A Transaction.

7. Permit the M&A Broker to participate in the negotiations of the M&A Transaction.

8. Apply only in an M&A Transaction that does not involve a public offering. Any securities received by the buyer or M&A Broker in an M&A Transaction will be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act of 1933 because the securities would have been issued in a transaction not involving a public offering.

Under no circumstances will an M&A Broker have custody, control, or possession of, or otherwise handle, funds or securities issued or exchanged in connection with an M&A Transaction or other securities transaction for the account of others. The requested relief would not be available in connection with an M&A Transaction that results in the transfer of interests to a passive buyer or group of passive buyers. The requested relief would also not be available in connection with an M&A Transaction in which any party to the transaction is a shell company, other than a business combination related shell company. The M&A Broker will not have the ability to bind a party to an M&A Transaction. The M&A Broker will not directly, or indirectly through its affiliates provide financing for any M&A Transaction. An M&A Broker that assists purchasers to obtain financing from unaffiliated third parties must comply with all applicable legal requirements, including, as applicable, Regulation T (12 CFR 220 et seq.), and must disclose any compensation in connection with the financing in writing to the client. Finally, any offering or sale in connection with an M&A Transaction will be conducted in compliance with an applicable exemption from registration under the Securities Act. The requested relief would not be available if the M&A Broker (and, if the M&A Broker is an entity, any officer, director or employee of the M&A Broker): (i) has been barred from association with a broker-dealer by the Commission, any state or other U.S. jurisdiction or any self-regulatory organization; or (ii) is suspended from association with a broker-dealer.

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13 We acknowledge that the handling of investor funds and securities in connection with securities activity could require a person to register as a broker-dealer.

14 The term "business combination related shell company" means a shell company (as defined in Securities Act Rule 405) that is:

- (1) Formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or
- (2) Formed by an entity that is not a shell company solely for the purpose of completing a business combination transaction (as defined in Securities Act Rule 165(f)) among one or more entities other than the shell company, none of which is a shell company.
Conclusion

Based upon the foregoing, we request assurance that the Staff would not recommend enforcement action with respect to the M&A Broker activities as described in this letter.

Sincerely,

Faith Colish, Esq., Carter Ledyard & Milburn LLP

Martin A. Hewitt, Esq., Attorney at Law

Eden L. Rohrer, Esq., Crowell & Moring LLP

Linda Lerner, Esq., Crowell & Moring LLP

Ethan L. Silver, Esq., Carter Ledyard & Milburn LLP

Stacy E. Nathanson, Esq., Crowell & Moring LLP
To amend the Securities Exchange Act of 1934 to exempt from registration brokers performing services in connection with the transfer of ownership of smaller privately held companies.

IN THE SENATE OF THE UNITED STATES
JANUARY 14, 2014

Mr. MANCHIN (for himself and Mr. VITTER) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

A BILL
To amend the Securities Exchange Act of 1934 to exempt from registration brokers performing services in connection with the transfer of ownership of smaller privately held companies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.
This Act may be cited as the “Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014”.

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SEC. 2. REGISTRATION EXEMPTION FOR MERGER AND ACQUISITION BROKERS.

Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)) is amended by adding at the end the following:

“(13) REGISTRATION EXEMPTION FOR MERGER AND ACQUISITION BROKERS.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), an M&A broker shall be exempt from registration under this section.

“(B) EXCLUDED ACTIVITIES.—An M&A broker is not exempt from registration under this paragraph if such broker does any of the following:

“(i) Directly or indirectly, in connection with the transfer of ownership of an eligible privately held company, receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transaction.

“(ii) Engages on behalf of an issuer in a public offering of any class of securities that is registered, or is required to be registered, with the Commission under section 12 or with respect to which the issuer files, or is required to file, periodic information,
documents, and reports under subsection (d).

“(C) RULE OF CONSTRUCTION.—Nothing in this paragraph shall be construed to limit any other authority of the Commission to exempt any person, or any class of persons, from any provision of this title, or from any provision of any rule or regulation thereunder.

“(D) DEFINITIONS.—In this paragraph:

“(i) CONTROL.—The term ‘control’ means the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. There is a presumption of control for any person who—

“(I) is a director, general partner, member or manager of a limited liability company, or officer exercising executive responsibility (or has similar status or functions);

“(II) has the right to vote 20 percent or more of a class of voting securities or the power to sell or direct
the sale of 20 percent or more of a class of voting securities; or

“(III) in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 20 percent or more of the capital.

“(ii) Eligible privately held company.—The term ‘eligible privately held company’ means a company that meets both of the following conditions:

“(I) The company does not have any class of securities registered, or required to be registered, with the Commission under section 12 or with respect to which the company files, or is required to file, periodic information, documents, and reports under subsection (d).

“(II) In the fiscal year ending immediately before the fiscal year in which the services of the M&A broker are initially engaged with respect to the securities transaction, the company meets either or both of the fol-
lowing conditions (determined in accordance with the historical financial accounting records of the company):

“(aa) The earnings of the company before interest, taxes, depreciation, and amortization are less than $25,000,000.

“(bb) The gross revenues of the company are less than $250,000,000.

“(iii) M&A BROKER.—The term ‘M&A broker’ means a broker, and any person associated with a broker, engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an eligible privately held company, regardless of whether the broker acts on behalf of a seller or buyer, through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the eligible privately held company, if the broker reasonably believes that—

“(I) upon consummation of the transaction, any person acquiring se-
securities or assets of the eligible privately held company, acting alone or in concert, will control and, directly or indirectly, will be active in the management of the eligible privately held company or the business conducted with the assets of the eligible privately held company; and

“(II) if any person is offered securities in exchange for securities or assets of the eligible privately held company, such person will, prior to becoming legally bound to consummate the transaction, receive or have reasonable access to the most recent year-end balance sheet, income statement, statement of changes in financial position, and statement of owner’s equity of the issuer of the securities offered in exchange, and, if the financial statements of the issuer are audited, the related report of the independent auditor, a balance sheet dated not more than 120 days before the date of the offer, and information
pertaining to the management, business, results of operations for the period covered by the foregoing financial statements, and material loss contingencies of the issuer.

“(E) INFLATION ADJUSTMENT.—

“(i) IN GENERAL.—On the date that is 5 years after the date of the enactment of the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014, and every 5 years thereafter, each dollar amount in subparagraph (D)(ii)(II) shall be adjusted by—

“(I) dividing the annual value of the Employment Cost Index For Wages and Salaries, Private Industry Workers (or any successor index), as published by the Bureau of Labor Statistics, for the calendar year preceding the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2012; and
“(II) multiplying such dollar amount by the quotient obtained under subclause (I).

“(ii) Rounding.—Each dollar amount determined under clause (i) shall be rounded to the nearest multiple of $100,000.”.

SEC. 3. EFFECTIVE DATE.

This Act and any amendment made by this Act shall take effect on the date that is 90 days after the date of the enactment of this Act.
September 8, 2014

The Honorable Joe Manchin  
306 Hart Senate Office Building  
Washington, DC 20510

The Honorable David Vitter  
516 Hart Senate Office Building  
Washington, DC 20510

Re: The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014 (S. 1923)

Dear Senator Manchin and Senator Vitter:

On behalf of the North American Securities Administrators Association (“NASAA”),¹ I am writing to express concern with S. 1923, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014. While NASAA shares your interest in establishing a more streamlined framework for the oversight of persons serving as brokers in mergers and acquisitions (“M&A”) deals that involve the transfer of securities, we are concerned that S. 1923 forgoes a number of important and reasonable investor protections. As such, NASAA cannot support the legislation in its present form.

Over the past four years, state securities regulators have worked closely with the American Bar Association, M&A practitioners, and other stakeholders, to fashion a streamlined registration framework for persons acting as M&A brokers. These collaborations served as the basis for legislation introduced in the House of Representatives on June 6, 2013 by Rep. Bill Huizenga (R-Mich). As proposed, Rep. Huizenga’s legislation, H.R. 2274, would establish a statutory exemption for M&A brokers, subject to key features, including: (1) the establishment of a streamlined electronic registration requirement with the Securities and Exchange Commission (“SEC”); (2) the disqualification of any broker or an associated person who is subject to suspension or revocation of registration; (3) the inapplicability of the exemption to any M&A transaction where one party or more is a shell company; and (4) the inapplicability of the exemption to M&A transactions involving a company with earnings in excess of $25 million, and gross revenue in excess of $250 million.

NASAA supported H.R. 2274 when it was introduced because it struck a good balance between the legitimate interests of all stakeholders while maintaining vital protections for

¹ The oldest international organization devoted to investor protection, NASAA was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.
investors and businesses. Unfortunately, when H.R. 2274 was considered by the House Financial Services Committee on November 14, 2013, the Committee adopted an amendment that removed key investor protection features, including the bill’s statutory “bad actor” disqualification provision; prohibitions on “shell” transactions; and a requirement for electronic registration by notice filing with the SEC.2 This amended version of H.R. 2274 was passed by the House of Representatives on January 14, 2014, and was subsequently introduced in the Senate as S. 1923, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2014.

Due to the removal of the investor protections described above, including the inexplicable removal from the bill of a basic and critical provision disqualifying “bad actors” from qualifying for the registration exemption established by the bill, NASAA cannot support H.R. 2274 and S. 1923. Although state securities administrators are disappointed that we cannot support the legislation, we continue to recognize a valid basis for a responsible statutory exemption from registration for persons acting as a broker in many M&A transactions. Moreover, we note that there appears to be consensus among many stakeholders that the basis for such legislation could be derived from the framework set forth in the “no-action” letter issued in final form by the SEC on February 4, 2014.3 However, should Congress consider legislation modeled on the SEC’s no-action letter, it should broaden the “bad-actor” disqualification to include not only persons having violated specific securities laws or SRO rules, but also other types of unlawful or unethical conduct. We would be grateful for the opportunity to work with you and other members of the Senate toward this end.

Thank you for your consideration of NASAA’s views. If I may be of additional assistance, please do not hesitate to contact me, or Michael Canning, NASAA Director of Policy, at (202) 683-2307.

Sincerely,

A. Heath Abshure
NASAA Federal Legislation Committee Chairman
Arkansas Securities Commissioner

cc: The Honorable Bill Huizenga
1217 Longworth House Office Building
Washington DC, 20515

2 See: H. Rept. 113-326

3 Although the SEC’s “no-action” letter does not define the parameters of the registration exemption according to the amount of revenue or earnings reported by the companies involved in transaction, such “size caps” are very important features of H.R. 2274 and S. 1923, and NASAA strongly urges that they be retained in any final bill.

[Nos. B032751, B034590.

Court of Appeals of California, Second Appellate District, Division Three.

June 21, 1989.]

ALL POINTS TRADERS, INC., Plaintiff and Appellant, v. BARRINGTON ASSOCIATES, Defendant and Respondent

(Opinion by Arabian, J., with Klein, P. J., and Danielson, J., concurring.)

COUNSEL

Nagler & Schneider and Marc E. Rohatiner for Plaintiff and Appellant.


John K. Van de Kamp, Attorney General, Arthur C. de Goede, Assistant Attorney General, William M. Pfeiffer and Steven A. Sokol as Amici Curiae, upon the request of the Court of Appeal.

OPINION

ARABIAN, J.
Introduction

This appeal raises the issue of whether an investment banking firm which specializes in mergers and acquisitions must possess a real estate broker's license when negotiating the sale of a business opportunity offered by a corporation seeking to transfer all of its stock to a prospective buyer. We hold that they must so possess.

Factual and Procedural Background

Petitioner and appellant All Points Traders, Inc., doing business as Sprink, Inc. (All Points), is a California corporation whose sole shareholders prior to the sale of its common stock were William F. Holbrook, Dollie R. Holbrook, James W. Holbrook and Anne holbrook. The corporation supplies pipe fittings, couplings and valves to the fire protection industry. Respondent Barrington Associates (Barrington), a California general partnership, [211 Cal. App. 3d 727] is an investment banking firm which specializes in mergers and acquisitions. None of its partners was a licensed real estate broker during the pertinent period.

About May 1986, James Holbrook met with James Freedman, a principal of Barrington. Their discussions led to a contract between All Points and Barrington which provided Barrington with the exclusive right to assist All Points in the sale of its "assets and/or common stock." Pursuant to the contract, Barrington agreed to "exercise [its] best efforts to sell the Company, or find an investor, on terms and conditions satisfactory to [All Points]." Barrington was to generate, screen and follow up on all leads, provide information about All Points to qualified buyers, prepare a corporate profile of All Points and assist in negotiations.

Ultimately, All Points itself located the purchaser of the business, although Barrington identified other prospective purchasers and handled initial negotiations with some of them. The sale included a transfer of All Points' common stock, payment of various consulting fees to the principals of All Points, and a lease with an option to purchase the land upon which the business was located.

On March 27, 1987, Barrington initiated binding arbitration before the American Arbitration Association, claiming a commission pursuant to its written agreement with All Points. All Points resisted Barrington's claim on a number of grounds, including Barrington's failure to possess a real estate broker's license. On November 25, 1987, the arbitrator awarded Barrington its claimed commission in the amount of $227,800, interest on a portion thereof and reasonable attorneys' fees.

All Points filed a petition and motion to vacate the arbitration award. The trial court denied
the petition and confirmed the arbitration award. All Points appealed from the subsequent judgment. Thereafter, All Points filed a motion for a new trial, vacation of the judgment and reconsideration of the order confirming the award. The trial court denied All Points' motion and All Points appealed from the order of denial. The two appeals were consolidated.

Contentions

All Points contends that Barrington's failure to be licensed as a real estate broker as required by Business and Professions Code section 10131 fn. 1 renders [211 Cal. App. 3d 728] the brokerage agreement void and illegal, and therefore the arbitration award must be vacated.

Barrington contends (1) it was not required to be licensed as a real estate broker because the licensing requirement does not apply to the sale of corporate stock, and (2) failure to confirm the arbitration award would result in All Points being unjustly enriched.

Discussion

1. The Business Opportunity Licensing Requirement and Its History

Originally, the licensing requirement for business opportunity transactions was distinct from that for real estate transactions. Some 52 years ago, the California Legislature enacted legislation requiring any person acting as a business opportunity broker or salesman to possess such a license. (Stats. 1937, ch. 785, §§ 1, 14, pp. 2235, 2245.) This requirement was codified in the Business and Professions Code in 1943 as a separate chapter of the Real Estate Law (§ 10250 et seq.) entitled "Business Opportunity Regulations," under the Department of Investment, Real Estate Division (former § 10000 et seq.). (Stats. 1943, ch. 127, § 1, p. 844.) From its inception, the business opportunity licensing requirement did not exempt incorporated businesses. fn. 2

In practice many business opportunity licensees also possessed a real estate broker's license. Nevertheless, confusion arose as to whether a business opportunity broker's license, a real estate broker's license or both were required, when a business opportunity transaction involved real estate. (Review of 1965 Code Legislature (Cont.Ed.Bar 1985) p. 14.) To simplify and clarify the law, the Legislature in 1965 merged the real estate and business opportunity licenses under the supervision of the Department of Real Estate. (Stats. 1965, ch. 172, p. 1133; ibid.) Thereafter, one who negotiated the sale of a business opportunity fell within the definition of a "real estate broker" (§ 10131), and was required to have a real estate license (§ 10130). fn. 3 [1] This historical background establishes that the definition of a "business [211 Cal. App. 3d 729] opportunity" does not necessarily include
real property, but that it may.

Subdivision (a) of section 10131 currently provides: "A real estate broker within the meaning of this part is a person who, for a compensation or in expectation of a compensation, regardless of the form or time of payment, does or negotiates to do one or more of the following acts for another or others: [¶] (a) Sells or offers to sell, buys or offers to buy, solicits prospective sellers or purchasers of, solicits or obtains listings of, or negotiates the purchase, sale or exchange of real property or a business opportunity." (Italics added.)

Section 10030 defines a "business opportunity": "As used in this part, the words 'business opportunity' shall include the sale or lease of the business and goodwill of an existing business enterprise or opportunity."

Real estate licensees must meet experience and training qualifications (§ 10150.6) and may be required to provide proof of honesty and truthfulness (§ 10153). (See Buckley v. Savage (1960) 184 Cal. App. 2d 18 [7 Cal.Rptr. 328], cert. denied 366 U.S. 910 [6 L.Ed.2d 235, 81 S.Ct. 1086].) The applicant must pass a written examination to demonstrate knowledge of English and arithmetical computation common to real estate and business opportunity practices, and an understanding of "the principles of real estate and business opportunity conveyancing, ... the principles of business and land economics and appraisals, ... the principles of real estate and business opportunity practice and the canons of business ethics pertaining thereto," as well as the regulations of the Real Estate Commissioner. (§ 10153.) [2] The purpose of these licensing requirements is to protect the public from incompetent or untrustworthy practitioners. (See Schantz v. Ellsworth (1971) 19 Cal. App. 3d 289, 292-293 [96 Cal.Rptr. 783].)

Without a required license, a person acting as a real estate broker as defined is unable to enforce a contract to seek recovery of any earned commission in a court of law. (§§ 10130, 10136.) fn. 4

2. The Definition of "Business Opportunity"

Until the current controversy, there has been little discussion over the meaning of "business opportunity" and the type of transaction requiring a [211 Cal. App. 3d 730] license. fn. 5 The few reported California opinions which concern the licensing requirements of the person who negotiates the sale of an incorporated business do not address the issue of the business opportunity licensing requirement, but rather the concomitant question of the need for a securities broker's license, often in addition to the business opportunity or real estate broker's license. In these cases, the acknowledged business opportunities or real estate transactions, which resulted in the transfer of corporate stock, concerned a building (Owen

Only Nationwide Investment Corp. v. California Funeral Service, Inc., supra, 40 Cal. App. 3d 494, presented a situation similar to the one here. The Nationwide court described the case as "atypical" in that plaintiff "Nationwide [sought] a commission for successfully negotiating the sale of a business to defendant although not licensed as a real estate broker or as a securities broker." (Id., at p. 499.) However, the Nationwide court did not address the real estate licensing issue but held that Nationwide, an investment company which negotiated the purchase of all the shares of a mortuary on behalf of a client, was required to have a securities broker's license as it was engaged in the business of effecting transactions in securities and therefore could not maintain an action to collect its commission. fn. 10

The Ninth Circuit Court has interpreted the California business opportunity licensing requirements in Meisner v. Reliance Steel & Aluminum Co. (9th Cir. 1959) 273 F.2d 49, holding that an out-of-state resident who assisted in finding a buyer for the "assets or capital stock" of Reliance Steel, a California corporation, and then actively participated in the negotiations resulting in the sale of the assets was required to have a business opportunity broker's license to maintain an action for his commission. (Id., at pp. 50, 53.)


Barrington contends that as a seller of stock has no vendible interest in the goodwill of the business carried on by the corporation and cannot transfer any part of it, a corporate stock
sale does not constitute a "business opportunity." fn. 11 This contention is meritless. There is no question that the sale in this case included a transfer of the goodwill of the business, affecting the purchase price. Furthermore, the goodwill of a business conducted by a corporation is the property of the corporation (Brown v. Allied Corrugated Box Co. (1979) 91 Cal. App. 3d 477, 488 [154 Cal.Rptr. 170]); therefore, the purchaser of the corporation not only acquired the "business" but the "goodwill" as well.

Barrington also contends that the Legislature has specifically declared that one who assists in the sale of corporate stock is not a real estate broker, citing section 10131.3. This contention is meritless as well.

Section 10131.3 provides: "A real estate broker within the meaning of this part is also a person who, for another or others, for compensation or in expectation of compensation, issues or sells, solicits prospective sellers or purchasers of, solicits or obtains listings of, or negotiates the purchase, sale or exchange of securities as specified in Section 25206 of the Corporations Code.

"The provisions of this section do not apply to a broker-dealer ... licensed by the Commissioner of Corporations ...." fn. 12 [211 Cal. App. 3d 733]

Section 10131.3 does not delete business opportunities transactions which are effected by means of a stock transfer, but adds to the definition of real estate broker those persons who assist in certain noncorporate securities transactions in small real estate investment entities. Section 10131.3 refers to those securities "as specified in Section 25206 of the Corporations Code," i.e., "any interest in any general or limited partnership, joint venture, unincorporated association, or similar organization, (but not a corporation) owned beneficially by no more than 100 persons and formed for the sole purpose of, and engaged solely in, investment in or gain from an interest in real property, including, but not limited to, a sale, exchange, trade or development." (Corp. Code, § 25206.) Adding these securities transactions, which are neither real estate nor business opportunity transactions, in no respect limits the definition of real estate broker in section 10131, subdivision (a).

3. The Sale of All Points

[5] The main thrust of Barrington's argument is that the sale of All Points was more in the nature of a securities transaction than the transfer of a business opportunity. Barrington suggests that when a business is transferred through the purchase and sale of stock, rather than a purchase of assets and goodwill, the business opportunity licensing requirements do not apply.
This view exalts form over substance of the regulated transactions and ignores the purposes of the regulation. The legal significance of such exaltation has been acknowledged by courts in various contexts. In Weber v. Jorgensen, supra, 16 Cal. App. 3d 74, the court held that a real estate broker was not required to have a securities broker's certificate to sue for his commission, even though the sale of the resort and marina business took the [211 Cal. App. 3d 734] form of a stock transfer. In so holding the court remarked: "From the complaint, we may infer that the shares of the corporation had been duly issued and were outstanding. Under these circumstances, it would normally be a matter of complete indifference to the buyers allegedly produced by plaintiff whether the resort and marina were being operated by defendant or by the corporation. The buyers, of course, would be at complete liberty to utilize the already existing corporate structure, or dissolve the corporation and operate the resort in their own proprietary capacity." (Id., at p. 85.) The court observed that many owners of investment property "often adopt the corporate form of ownership and organization for tax and other purposes" and that "the services of real estate brokers as well as many other specialists are so often essential to the guidance of property owners in the handling and disposition of their property." (Id., at pp. 85-86.)

Similarly, in holding that the sale of an executive placement firm was not a sale of securities for purposes of the Corporate Securities Act qualification requirement, the California Supreme Court stated in Fox v. Ehrmantraut (1980) 28 Cal. 3d 127, 138-140 [167 Cal.Rptr. 595, 615 P.2d 1383], that California courts look through form to substance to further the purposes of the act. The Court contrasted securities transactions with the sale of a business:

"It is settled that the Corporate Securities Law was not intended to afford supervision and regulation of instruments which constitute agreements with persons who expect to reap a profit from their own services or other active participation in a business venture. Such contracts are clearly distinguished from instruments issued to persons who, for a consideration paid, stipulate for a right to share in the profits or proceeds of a business enterprise to be conducted by others; and the court will look through form to substance to discover whether in fact the transaction contemplates the conduct of a business enterprise by others than the purchasers, in the profits or proceeds of which the purchasers are to share. [Citations.]" (28 Cal. 3d at p. 139.)

We find that the sale of All Points was in substance the sale of a "business opportunity," even though it was accomplished through a transfer of corporate shares, and therefore the person negotiating the transaction was required to have a real estate broker's license. Whether such transaction also [211 Cal. App. 3d 735] fell within the scope of securities regulations is irrelevant. fn. 13 Regulation under one statute or regulatory scheme does not
preclude regulation pursuant to other statutory provisions. fn. 14 Although the Legislature has provided for coordination of regulation between the Commissioner of Corporations and the Real Estate Commissioner in certain limited areas of real estate-related securities, the statutory scheme provides no indication that business opportunity regulation and securities regulation in general are mutually exclusive or dismembered from one another. In fact, our review discloses a legislative intention to provide a synthesis of harmony.

4. The Inability to Enforce the Arbitration Award


[6] Accordingly, every reasonable intendment is indulged to give effect to arbitration proceedings. "Courts may not examine the merits of the controversy, the sufficiency of the evidence supporting the award, or the reasoning supporting the decision. [Citation.] A court may not set aside an arbitration award even if the arbitrator made an error in law or fact. [Citations.]" (Lindholm v. Galvin (1979) 95 Cal. App. 3d 443, 450-451 [157 Cal.Rptr. 167], italics in original.)

"Under certain circumstances an award based on an error in law may be set aside on the ground that it was in excess of the arbitrator's powers. (Code Civ. Proc., § 1286.2, subd. (d); Abbott v. California State Auto. Assn. (1977) 68 Cal. App. 3d 763, 770 [].) [7] A trial court, however, is limited in its authority to vacate the award of an arbitrator, even in the event of an error of fact or law. The mere fact that an arbitrator reached an erroneous conclusion based on an error of law which does not appear on the face of the record will not invalidate the award; on the other hand, where the error appears on the face of the award and causes substantial injustice the award may be vacated. (Hirsch v. Ensign (1981) 122 Cal. App. 3d 521, 529 []; Abbott v. California State Auto. Assn., supra, 68 Cal. App. 3d at p. 771.)" (Ray Wilson Co. v. Anaheim Memorial Hospital Assn. (1985) 166 Cal. App. 3d 1081, 1090-1091 [213 Cal.Rptr. 62].) fn. 15

In Loving & Evans v. Blick (1949) 33 Cal. 2d 603 [204 P.2d 23], the parties to a building contract submitted to arbitration a dispute over the amount of payment due. The property owner asserted that the contractors were not properly licensed. The parties stipulated that one of the partners and the partnership itself did not have contractor's licenses during performance of the work. The arbitrator found in favor of the contractors and the trial court affirmed the arbitration award.
In reversing the confirmation, the Supreme Court explained: "[I]t has been repeatedly declared in this state that 'a contract made contrary to the terms of a law designed for the protection of the public and prescribing a penalty for violation thereof is illegal and void, and no action may be brought to enforce such contract.' [Citations.] ..."

"[T]he rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable where the issue of [211 Cal. App. 3d 737] illegality of the entire transaction is raised in a proceeding for the enforcement of the arbitrator's award. When so raised, the issue is one for judicial determination upon the evidence presented to the trial court, and any preliminary determination of legality by the arbitrator, whether in the nature of a determination of a pure question of law or a mixed question of fact and law, should not be held to be binding upon the trial court." (Id., at pp. 607, 609; Webb v. West Side District Hospital (1983) 144 Cal. App. 3d 946, 949 [193 Cal.Rptr. 80].)

"[I]t is generally held that 'a claim arising out of an illegal transaction is not a proper subject matter for submission to arbitration, and that an award springing out of an illegal contract, which no court can enforce, cannot stand on any higher ground than the contract itself.'" (Loving & Evans v. Blick, supra, 33 Cal. 2d at p. 610, citation omitted.)

Inherent in the arbitration award granting Barrington a commission for its involvement in the sale of All Points is the finding that the underlying contract was legal and enforceable. [8] However, the issue of illegality is one for judicial determination upon the evidence presented to the trial court, and the arbitrator's finding, whether in the nature of a determination of a pure question of law or a mixed question of fact and law, is not binding on the trial court. (Loving & Evans v. Blick, supra, 33 Cal. 2d 603, 609.)

[9] Barrington contends that it is entitled to recover its fee from All Points because at the time of execution of the contract it was not "a clear violation" of law or public policy to assist in the sale of a client's corporate stock without possessing a real estate broker's license, in contrast to the situation in Loving & Evans v. Blick, supra, 33 Cal. 2d at page 607. They suggest that the statutory language is unclear in its command that a merger and acquisition specialist must possess a real estate broker's license, pointing to the declarations of various individuals in the industry that it was the "custom and practice" of members of the investment banking community not to be so licensed. They also argue that no evidence was produced that the Department of Real Estate has "any consistent enforcement policy regarding the sale of corporate stock by an investment banker and/or merger and acquisition specialist which does not possess a real estate broker's license," and claim that its principals were "extremely qualified by way of background and experience" to perform the contract.
We recognize and acknowledge that there may be special circumstances where the purpose of the legal requirement would not be advanced by [211 Cal. App. 3d 738] denying relief. "[R]ules denying relief to parties to illegal contracts are subject to a wide range of exceptions. In each case, the grant or refusal of relief depends upon the public interest involved in the particular kind of illegality, including the policy of the transgressed law. (See, 6A Corbin, Contracts (1962), § 1534, pp. 818-819.) 'In each such case, how the aims of policy can best be achieved depends on the kind of illegality and the particular facts involved.' (Lewis & Queen v. N. M. Ball Sons (1957) 48 Cal. 2d 141, 151 [308 P.2d 713].)"

In Weber v. Jorgensen, supra, 16 Cal. App. 3d at pp. 84-85.) In Weber, discussed above, the court found the lack of a securities broker's certificate raised "no public policy objection in the nature of the services alleged by plaintiff ...." (Ibid.) The requirement for a certificate was unimportant under the facts of the case. The seller had instructed the plaintiff that the transfer of the corporate stock was incidental to the sale of the real property, and that the stock transfer agreement would be prepared and handled by an attorney, not by the real estate broker plaintiff.

This is not such a case. Enforcement of the contract for a commission would be in direct contravention of the statute and against public policy. That conclusion is not altered by the fact that there may be persons engaging in similar activities who have unintentionally misconstrued the law and may face harsh consequences. However, "[c]onsequences cannot alter statutes, but may help to fix their meaning" fn. 16 The Department of Real Estate, as amicus, has expressed its opinion that section 10131 applies in the case of a sale of a corporate business opportunity. Certainly the sale of All Points, as an ongoing enterprise, was not "incidental" to the sale of its stock. Indeed, the only purpose of the stock transfer was to effect the sale of the business itself.

The Legislature selected the specific means to protect the public and has expressed its intention in section 10136 which states, "No person engaged in the business or acting in the capacity of a real estate broker or a real estate salesman within this State shall bring or maintain any action in the courts of this State for the collection of compensation for the performance of any of the acts mentioned in this article without alleging and proving that he was a duly licensed real estate broker or real estate salesman at the time the alleged cause of action arose." In light of the statute's mandatory dictation, we must conclude that Barrington cannot pursue its action for a commission. [211 Cal. App. 3d 739]

Barrington lastly contends that All Points will be unjustly enriched if the contract is not enforced. However, this court cannot "resort to equitable considerations in defiance" of the mandate of the Legislature. (See Lewis & Queen v. N. M. Ball Sons (1957) 48 Cal. 2d 141, 152 [308 P.2d 713].)
5. Attorney's Fees

Having ultimately prevailed, All Points is entitled to attorney's fees as provided in the parties' agreement. (Code Civ. Proc., § 1717; M. C. & D. Capital Corporation v. Gilmaker (1988) 204 Cal. App. 3d 671 [251 Cal.Rptr. 178].)

Disposition

Judgment reversed and the case remanded to the trial court for further proceedings consistent with this opinion. All Points is awarded costs on appeal.

Klein, P. J., and Danielson, J., concurred.

FN 1. All statutory references are to the Business and Professions Code unless otherwise indicated.

FN 2. Otherwise there would have been no need to exempt corporations engaged in transactions involving their own property, as provided in the original statute: "The provisions of this act shall not apply to anyone who shall directly perform any of the acts aforesaid with reference to his own property or, in the case of corporations, through their regular officers receiving no special compensation therefor perform any of the acts aforesaid with reference to their, to wit, said corporations, own property ...." (Stats. 1937, ch. 785, § 2, p. 2236.) (Tognazzini v. Jordan (1913) 165 Cal. 19, 23 [130 P. 879].)

FN 3. Section 10130 provides: "It is unlawful for any person to engage in the business, act in the capacity of, advertise or assume to act as a real estate broker or a real estate salesman within this state without first obtaining a real estate license from the department."

FN 4. In regard to partnerships, such as Barrington, section 10137.1 provides: "Nothing contained in this division shall preclude a partnership from performing acts for which a real estate broker license is required, provided every partner through whom the partnership so acts is a licensed real estate broker."

FN 5. A number of California cases have dealt with the issue of the "finder's exception" which exempts a person who merely finds a buyer, but does not negotiate a transaction, from the licensing requirements. (See, e.g., Crofoot v. Spivak (1952) 113 Cal. App. 2d 146 [248 P.2d 45].) The parties do not contend that the finder's exception applies in this case.

FN 6. In Owen v. Off, supra, 36 Cal. 2d 751, the California Supreme Court held that a licensed real estate broker could not enforce a contract for a commission for his services in connection with the sale of corporate stock because he was not licensed as required by the
Corporate Securities Act. The real estate broker was employed to sell a building but before he could find a purchaser it was decided for tax purposes to sell the stock in the corporation which owned the building. (Id., at p. 753.)

FN 7. In Stoll v. Mallory, supra, 173 Cal. App. 2d 694, a licensed real estate and business opportunity broker "was engaged to secure a purchaser for a radio station business, not to find a buyer for Peabody's stock. [Peabody owned all but about 150 shares of the 7,000 outstanding shares of the company. (Id., at p. 696.)] Mallory's [the manager of the radio station] first letter to plaintiff states: 'We would like to receive $150,000 for the station ...' (Emphasis added.) Plaintiff did not learn that Peabody wished to sell his stock until the buyers and seller were brought together. The memorandum of agreement signed by them stated that Peabody [was] selling his interest in the 'Broadcasting Company and its radio station K.s.J.O., together with all equipment, land, buildings, supplies and other assets ...' The memorandum further stated: 'Incident to this sale, seller guarantees to deliver 100% of the corporate stock ... delivery of the assets agreed to be sold will be made free and clear of all encumbrances ...' (Emphasis added.) Plaintiff did not participate in the negotiations other than to bring the parties together and at no time did he represent himself as dealing in stocks or offer for sale or negotiate the sale of stock." (Id., at p. 699.) The court held that plaintiff could recover his commission because he was not required to be licensed under the Corporate Securities Act. It distinguished Owen v. Off, supra, as a case where the plaintiff was employed by the defendants for compensation to sell their stock.

FN 8. Weber v. Jorgensen, supra, 16 Cal. App. 3d 74, held that a licensed real estate broker was not required to have a securities broker's certificate to sue for his commission. At the time of the original listing agreement for the sale of Echo Chalet resort and marina business, the sole shareholder and owner instructed the broker plaintiff that he would transfer title to the property (consisting of a lease, a special use permit, a license, improvements and personal property thereon) (id., at p. 77) by transferring all the stock in his corporation, Echo Chalet, Inc., which held the lease, permits and licenses, to the buyers, "as an incident to the sale of the property, and that the stock transfer agreement would be prepared and handled by an attorney and not by the plaintiff." (Id., at pp. 82-83, italics in original.)

FN 9. Lyons v. Stevenson, supra, 65 Cal. App. 3d 595, held that the real estate broker was entitled to his commission even though he was not licensed as a corporate securities broker. The court found no public policy objection to his recovering a commission even though he knew that the mortgage company which was sold was a corporation. The court explained that the broker was not retained to sell securities and neither the plaintiff nor defendant considered the method by which the "business" would be transferred. (Id., at p. 603.)
FN 10. The court limited its holding to the securities broker's license issue: "We agree with the parties that this was a securities transaction, and we determine only whether Nationwide was a broker-dealer and required to have a securities broker's license." (National Investment Corp. v. California Funeral Service, Inc., supra, 40 Cal. App. 3d 494, 499.) However, in dicta the court noted: "[H]ad Humphrey Chula Vista Mortuary not been a corporation but had sold all of its assets instead of stock to CFS, with Nationwide being the intermediary and negotiating the deal, Nationwide would have been required to have a real estate broker's license." (Id., at p. 502, fn. 8.)

FN 11. The original 1937 statute provided that "the words 'business opportunity' shall mean and include business, business opportunity and/or good will of an existing business." (Stats. 1937, ch. 785, § 2, p. 2236.) When the business opportunity licensing requirements were combined with the real estate licensing requirements in 1965, the definition was changed to its current language: "As used in this part, the words business opportunity shall include the sale or lease of the business and goodwill of an existing business enterprise or opportunity." (Stats. 1965, ch. 172, § 3, p. 1134.)

FN 12. A securities broker-dealer is required to be licensed by the Commissioner of Corporations. Corporations Code section 25210 provides: "(a) Unless exempted under the provisions of Chapter 1 (commencing with Section 25200) of this part, no broker-dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in this state unless such broker-dealer has first applied for and secured from the commissioner a certificate, then in effect, authorizing such person to act in that capacity.

"(b) No person shall, on behalf of a broker-dealer licensed pursuant to Section 25211, or on behalf of an issuer, effect any transaction in, or induce or attempt to induce the purchase or sale of, any security in this state unless such broker-dealer and agent have complied with such rules as the commissioner may adopt for the qualification and employment of such agents."

Section 25206 of the Corporations Code referred to in the real estate licensing provision of section 10131, provides: "A broker licensed by the Real Estate Commissioner is exempt from the provisions of Section 25210 [requiring broker/dealer licensing] when engaged in transactions in any interest in any general or limited partnership, joint venture, unincorporated association, or similar organization (but not a corporation) owned beneficially by no more than 100 persons and formed for the sole purpose of, and engaged solely in, investment in or gain from an interest in real property, including, but not limited to,
a sale, exchange, trade or development. ..."

FN 13. this issue is not before us. Barrington contends that, as a merger and acquisition firm, it is exempt from the securities broker licensing requirement of Corporations Code section 25210 pursuant to a rule promulgated by the Commissioner of Corporations. All Points does not dispute this contention.

The exemption for merger and acquisition firms is set forth in title 10 of the California Code of Regulations, section 260.204.5, which provides: "An exemption from the provisions of Section 25210 of the Code is hereby granted, as being necessary and appropriate in the public interest and for protection of the investors, to any person who effects transactions in securities in this state only in connection with mergers, consolidations or purchases of corporate assets, and who does not receive, transmit or hold for customers any funds or securities in connection with such transactions."

FN 14. The securities-broker exemption recognizes that merger and acquisition firms effect transactions which are unlike the usual securities transaction. In Commissioner's Opinion No. 76/15C, the Commissioner of Corporations addressed the applicability of the exemption to transactions which do not appear to fall within the "language" of the rule. "For example, two companies may commence discussions of a possible combination of their enterprises. The exact type of transaction by which the combination will be effected will be a product of accounting, tax and legal advice. The transaction may be a merger, consolidation or purchase of corporate assets or an exchange of shares or purchases of one company's shares by another." The Commissioner explained that "the exemption from the certification requirement of Section 25210 of the law provided by Rule 204.5 is intended to apply to those broker-dealers whose activities are limited to bringing together companies for the purpose of forming a single enterprise. While the Rule uses the terms 'mergers, consolidations, or purchases of corporate assets,' these terms, especially consolidation, must be interpreted more broadly than as used in other Sections of the Law .... Accordingly, a broker-dealer whose intent is to effect transactions only in connection with mergers, consolidations or purchases of corporate assets and who meets the other requirements of Rule 204.5, may avail himself of the exemption provided by that Rule if the transactions in which it participates take forms which do not fall within the literal terms of the exemption because of advice other than the advice of the broker-dealer."

FN 15. Code of Civil Procedure section 1286.2, subdivision (d) provides as follows: "Subject to Section 1286.4, the court shall vacate the award if the court determines that: [¶] (d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted ...."
November 8, 2006

Craig McCrohon, Esq.
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131 South Dearborn Street
Chicago, IL 60603

Re: Country Business, Inc. Request for No-Action Relief

In your letter dated November 8, 2006, on behalf of Country Business, Inc. ("CBI"), you request assurance that the staff of the Division of Market Regulation ("Staff") will not recommend enforcement action to the Commission under Section 15(a) of the Securities Exchange Act of 1934 ("Exchange Act") if CBI engages in the activities described in your letter without registering as a broker-dealer under Section 15(b) of the Exchange Act.

Based on the facts and representations set forth in your letter, the Staff will not recommend enforcement action to the Commission under Section 15(a) of the Exchange Act if CBI engages in the activities you describe without registering as a broker-dealer. We note in particular your representations that: (1) if a decision is made to effect the transaction by a sale of securities, CBI will have a limited role in negotiations between the seller and potential purchasers or their representatives as described in your letter and will not have the power to bind either party in the transaction; (2) the business represented by CBI is a going concern and not a "shell" organization; (3) the Selling Company satisfies the size standards for a "small business" pursuant to the Small Business Size Regulations issued by the U.S. Small Business Administration; (4) only assets will be advertised or otherwise offered for sale by CBI; (5) if the transaction is effected by means of securities, it will be a conveyance of all of the business's equity securities to a single purchaser or group of purchasers formed without the assistance of CBI; (6) CBI will not advise the two parties whether to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold (other than by valuing the assets of the business as a going concern); (7) CBI's compensation will be determined prior to the decision on how to effect the sale of the business, will be a fixed fee, hourly fee, a commission, or a combination thereof, that is based upon the consideration received by the seller, regardless of the means used to effect the transaction and will not vary according to the form of conveyance (i.e., securities rather than assets); (8) CBI's compensation will be received in the amounts and at the times as described in your letter; and (9) CBI will not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.

This position is based on the facts presented and the representations you have made, and any different facts and circumstances may require a different response. Furthermore, this response expresses the Staff's position on enforcement action only and does not purport to express any legal conclusions on the question presented. The Staff expresses no view with respect to any other questions that the proposed activities may raise, including the applicability of any other federal or state laws or self-regulatory organization rules.

Sincerely,

Brian A. Bussey
Assistant Chief Counsel