
Getting Paid and Staying Out of Jail: Selected Laws Regulating Business Brokers

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Big Brother versus Busy Broker

Brokers Tangled in a Legal Web

- **Illinois Business Brokers Act**

815 ILCS §307

State regulation of business brokers.

- **Securities Exchange Act of 1934**

Federal regulation of stock brokers and others

- **Illinois Real Estate License Act**

225 ILCS 454

General license for real estate brokers; provides lien rights.

- **Illinois Franchise Disclosure Act**

815 ILCS 705

- **Court-made law**

- **Other State Laws Regarding Real Estate Brokers**

Sometimes involves businesses, business opportunities, or expansive definitions of real estate

When Legal Rubber Hits the Regulatory Road

- Defense raised by client in legal disputes
- Disgruntled client, or aggressive competitor reports the broker
- When the broker becomes involved in other regulated activities, such as money management, or accounting work
- Crossfire between the battle of industry groups, such as real estate brokers versus securities dealers

Here Come the Regulators

- Real Estate Brokers –
 - Illinois Department of Banks and Real Estate
- Securities Brokers –
 - National Association of Securities Dealers
 - Securities Exchange Commission
 - Illinois Secretary of State/Securities Department
- Business Broker
 - Illinois Secretary of State/Securities Department
- Illinois Franchise Disclosure Act
 - Illinois Attorney General
- Other state real estate laws
 - Real estate commissions, banking departments

The Illinois Business Brokers Act

The Oddity of the Business Brokers Act

- Only state with such a law
- 815/ILCS §307.10-1; other states rely on their real estate brokers laws
- The unlikely marriage of securities laws and broker laws
 - Securities laws:
 - ❖ Aimed at Wall Street, publicly traded stocks and bonds. Goals: protect customer money; ensuring full disclosure; monitor large number of small transactions (e.g.: keeping copies of contracts, record maintenance provisions, maintenance of scripts of broadcast advertising, fraud standards from securities laws - implies that the purchase does not have as much contact with the seller as is the case with a small business); temper securities speculation; born of the '29 stock market crash
 - Broker laws:
 - ❖ Establish professional standards; clarify the relationship between the broker and the customer

Business Brokers Act: Overview

- All business brokers must register with the Secretary of State

§10-10 Could help those registered in Illinois

- Mandated disclosure document

§10-30

Loop Holes Galore

- Exceptions to disclosure swallow the rule

§10-30.5

- Accredited individual investors (\$1 million net worth or \$200,000 per year income)
- Assets of the client company exceed \$1 million
- Gross revenues of the company of more than \$200,000
- The client company is owned by an accredited investor

A Deck of Get-Out-of-Jail-Free Cards

- Banks and savings and loans
§10-80(b)
- Attorneys, where work is incidental to practice of law
§10-80(b)(1)
- Accounts where the work is related to incidental to work as a CPA
§10-80(b-2)
- Licensed real estate broker not primarily working as a business broker
§10-80(b)(1)
- Certain licensed broker dealers, investment advisors, and other securities professionals
§10-80(a)(3-6)
- Publishers of advertising
§10-80(b-3)

The Bad News: fines

Theoretically, stiff penalties imposed:

- Class 4 Felony
§10-65
- Liability to client
§10-60
- \$10,000 fine for each violation
- Liability to the clients:
 - Fees paid
§10-55
 - Interest and attorneys fees
§10-60

Lien and Mean

- Lien on the tangible assets (real estate and tangible personal property) of the business
10-115(a)
- Liens against the purchaser: 90 days from closing; attaches when filed; must provide notice within 10 days of filing
10-115(e)
- Must bring suit within two years
10-115(h)
- Foreclosure procedures: Illinois Mortgage Foreclosure Law (for real estate), Uniform Commercial Code (for personal property)
10-115(i)
 - Concerns about constitutionality
- Must release lien five days after payment
10-115(m)
- Priority over non-recorded liens (extremely powerful)
10-115(o)

The Sleeper of the Year:
The Securities Exchange Act

Case of Mistaken Identity

- Applies in stock sales, debt offerings
- Main Street Business Broker caught in a technicality as a Wall Street Stock Broker
- Regulates the re-sale of securities
- Governs sales by companies and individuals
- Governs practices by people who promote sales - that is brokers and dealers
- Imposes disclosure standards, professional competency standards, and business practices

Securities Act: General Rule Regarding Brokers

- Unlawful for any broker or dealer (other than a broker or dealer whose business is exclusively intrastate) to effect transactions in, or induce one to purchase securities unless the broker or dealer is registered.

Exchange Act §15(a)(1)

- Applies to the sale of private as well as public securities
- If offering qualifies under regulation D, brokers must nevertheless often be registered

SEC Compliance Guide to the Registration and Regulation of Brokers and Dealers
(October 1998)

Officer, You've Got the Wrong Person . . .

- When is a broker (of businesses) a broker (of securities)
- Exchange Act definition of “broker”:
Any person engaged in the business of effecting transactions in securities for the account of others.
Exchange Act §3(a)(4)

What About Sale of the Business Exemption

- Sale of business doctrine:
 - If sale of control, then not a “security”
 - Doctrine and exemption rejected by the U.S. Supreme Court
- *Landreth Timber Co. v. Landreth* (U.S. Supreme Court, 1985)
 - In a nutshell: a security is a security, whether one or one hundred percent of the company

The Useless “Intrastate” Exemption

- Strictly construed by the Securities and Exchange Commission and the courts:

Any transaction involving any associate outside of the state will likely disqualify broker from qualifying for the exemption.

- *Jammer Cycle Products, Inc.* (June 26, 1973); *Fifty Fla. Corp.* (July 31, 1973).
- May include the use of “interstate” instrumentalities of commerce, such as the U.S. mail or the internet
- Elements likely to render the brokering inter-state: Joint brokerage with non-Illinois firm, assets located outside of Illinois, any principals located outside of Illinois, office or principal located outside of Illinois

The Finder Exemption

- If only a finder, then not a broker requiring exemption
 - [Davenport Management, Inc. \(SEC 1993\)](#)
- Who qualifies as a finder: The broker who DOES NOT:
 - Participate in negotiations and structuring of the investment terms
 - Recommend and discusses the merits of the security
 - Receive a commission based on the price of the securities sold
 - Prior registration as a broker
 - Receive money or securities

Weekend Warrior Exemption

- If only an “occasional” securities deal, arguably exempt
 - Danger: Little Precedent for this argument
- One view: Registration required whether the person is “an amateur or professional”, whether full or part time

Boruski v. SEC, (2nd Cir. 1961)

- Absence of cases for firms that completed only a handful of transactions per year
- Absence of cases and letter rulings involving sole proprietorship business brokerage firms
- Rules of thumb

How to Comply

- Registration with the National Association of Securities Dealers (NASD)
- Registration with state securities departments
- Completing the Series 7 Examination (general rep.); Series 24 (securities principals); Series 27 (financial operations principal)
- Fingerprint forms, background checks, submission of literature to NASD for review
- Drafting and submission of business plan to NASD
- Maintain a fidelity bond
- Audited financial statements

Ongoing Compliance

- NASD Rule restricting taking of referral fees from non-NASD registered firms
NASD Rule 2420
- Record keeping requirements
- Filing of regular forms with the NASD and the SEC
- Continuing education to maintain license
- Capital requirements (de minimis)
- Informational disclosures to regulators: information regarding employees, corporate affiliates

Between a Rock and Hard Place

- Consequences of being registered: Restrictions regarding:
 - Communications with the public
 - Discussing the details of a particular security
 - Recommending the purchase of the security
 - Method of accepting the securities order

The Little Law: The Illinois Securities Act

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Illinois State Securities Act

- Generally requires registration of “Dealers” (including brokers)
 - 815 ILCS 5/8(A)
- Exceptions almost completely swallow the rule:
 - Sales to corporations
 - ✦ Incorporating 815 ILCS 5/4(A)
 - Private, Reg D-type offerings (assuming not in the business of such offerings; fewer than 35 purchasers, less than \$1 million; only accredited investors)
 - ✦ Incorporation 5/4(G), (H)

The Illinois Real Estate License Act

Real Estate License Statutes

- Where real estate is the primary element

225 ILCS 454 Real Estate License Act of 2000

- Where real estate is involved in another state, and split commissions contemplated
- Where real estate is a significant component, and the broker intends to file a lien on this asset

Real Estate Brokerage Reciprocal Licenses

Currently Illinois has reciprocity with the following states under the Real Estate License Act of 2000:

Colorado

Connecticut

Georgia

Indiana

Iowa

Kentucky

Missouri

Nebraska

South Dakota

Practical Guides

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The Danger Zone

More likely to require registration IF:

- ❑ Business broker is an affiliate of an accounting firm
- ❑ Multiple broker offices
- ❑ Firms with brokers with members in more than one state
- ❑ Firms that also post listings of deals
- ❑ Firms that regularly complete more than 10 stock deals or debt offerings per year
- ❑ Firms that include professionals that are, or were, registered brokers
- ❑ Engage in other regulated activities (such as accounting, investment of funds)
- ❑ Capital raising projects

Practical Points: Managing the Transaction

- Publications/listing services: should aim for the finder exemption
- Number of states with clients
- Extent of the marketing of businesses: general announcements, specific calls, referrals only
- Type of purchaser: individual or businesses

Practical Points: Managing the Firm

- Rule of thumb regarding number of stock deals: some states provide for five or fewer
- Any partners are or were registered as brokers
- Number of partners or employees managing transactions
- Number of states with clients
- Extent of the marketing of businesses: general announcements, specific calls, referrals only

Practical Points: Limiting Disputes

- CLEAR contracts
 - When compensation paid, especially in cases of earn outs, assumed liabilities
- Clear tail clauses: applies for one year, other limits
- AVOID time periods and amounts with no limits
- ACKNOWLEDGE that some leads might come from persons other than the intermediary (such as the client)
- DOCUMENT hard work and continuous communication
- If possible: draft agreement to list elements of the finder exemption

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