

# SALES OF BUSINESSES — WHEN ARE BUSINESS BROKERS SECURITIES BROKERS?

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## I. INTRODUCTION

The Securities Exchange Act of 1934<sup>1</sup> was enacted to provide for the regulation of this nation's securities markets and the securities professionals participating in those markets. The Exchange Act, among other things, creates a scheme of regulation for brokers or dealers in securities. Except for certain statutory exclusions, a broker or dealer in securities is required to register on both a state<sup>2</sup> and federal<sup>3</sup> level. Whether a business broker, financial consultant or other intermediary is required to register as a "broker-dealer" under the Exchange

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1. 15 U.S.C. §§ 78a-kk (1984) [hereinafter Exchange Act]. The Exchange Act regulates the trading of securities already issued and outstanding.

2. UNIF. SEC. ACT § 101(a), 7A U.L.A. 561 (master ed. 1978) [hereinafter Uniform Act]. See generally Note, *Interstate Scope of the Uniform Securities Act — A Case Analysis*, 1974 WASH. U.L.Q. 421. The National Conference on Uniform State Laws and the American Bar Association promulgated a Uniform Securities Act in 1956. The 1956 Act has been substantially adopted in thirty-six states in addition to the District of Columbia, Guam, and Puerto Rico. For citations to these jurisdictions see Newman, *Municipal Securities and State Securities Laws: A New Look*, 13 U. BALT. L. REV. 558, 558-59 n.3 (1984). The following states have not adopted the 1956 Uniform Act: Arizona, California, Florida, Georgia, Illinois, Louisiana, Maine, New York, North Dakota, Texas, and Vermont.

It should be recognized that in 1985 the National Conference of Commissioners on Uniform State Laws approved a revised Uniform Securities Act. See 1 Blue Sky L. Rep. (CCH) ¶ 5593. However, the American Bar Association has not given its approval to the revised Act, which is essential to the Act achieving the status of a "Uniform Act." See Hensley, *The Development of a Revised Uniform Securities Act*, 40 BUS. LAW. 721 (1985). Therefore, the 1956 Act is still officially the Uniform Securities Act.

3. Exchange Act § 15(a)(1), 15 U.S.C. § 78(a)(1) (1984).

Act generally depends on two factors: (1) whether the activities bring him within the statutory definitions of a broker<sup>4</sup> or dealer;<sup>5</sup> and (2) whether an exemption from registration is available notwithstanding a broker's or dealer's activities.

In *Landreth Timber Co. v. Landreth*,<sup>6</sup> the United States Supreme Court held that the sale of a controlling interest in a business effected by the sale of its stock constituted a securities transaction.<sup>7</sup> Accordingly, the transaction was entitled to the protection of the federal securities laws. As a result of this decision there has been a heightened concern over the application of broker-dealer registration requirements under the Exchange Act and state blue sky laws to business brokers.<sup>8</sup>

This article will examine the application of broker-dealer registration requirements to business brokers. In making this examination, this article will first address the applicability of securities laws to business brokers.<sup>9</sup> Second, this article will attempt to define the scope of activities a business broker may engage in without being required to register under the Ex-

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4. Section 3(4) of the Exchange Act provides that a broker is "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." 15 U.S.C. § 78(a)(4) (1984).

5. Section 3(5) of the Exchange Act defines a dealer as:  
any person engaged in the business of buying *and* selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.  
15 U.S.C. § 78c(5) (1984) (emphasis added).

6. 471 U.S. 681 (1985).

7. *Id.* at 697. Prior to the Court's holding in *Landreth* both courts and commentators were sharply divided over the issue of whether the sale of a controlling interest in a business constituted a securities transaction. Compare Seldin, *When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws*, 37 BUS. LAW. 637 (1982); Thompson, *The Shrinking Definition of a Security: Why Purchasing All of a Company's Stock is Not a Federal Security Transaction*, 57 N.Y.U. L. REV. 225 (1982); Note, *The Sale of Business Doctrine: A Decade After Forman*, 49 BROOKLYN L. REV. 1325 (1983) (sale of business interest not a security transaction) with Hazen, *Taking Stock of Stock and the Sale of Closely Held Corporations: When is Stock Not a Security?*, 61 N.C.L. REV. 393 (1983); Prentice & Roszkowski, *The Sale of Business Doctrine: New Relief from Securities Regulation or a New Haven for Welshers?*, 44 OHIO ST. L.J. 473 (1983) (sale of business interest is a security transaction).

8. See, e.g., International Business Exch. Corp., SEC No-Action Letter (Dec. 12, 1986).

9. See *infra* notes 13-44 and accompanying text. This article is restricted to federal and state securities laws concerns and does not address the applicable state business opportunity brokerage or real estate brokerage statutes.

change Act and state blue sky laws.<sup>10</sup> Third, it will summarize the federal and state consequences of a business broker failing to register as a securities broker-dealer.<sup>11</sup> Finally, this article will offer guidance to practicing attorneys to minimize the civil or criminal liability exposure for sellers or business brokers in the sale of a business under federal and state securities laws.<sup>12</sup>

## II. RELATIONSHIP OF THE DEFINITION OF A SECURITY TO THE BROKER-DEALER REGISTRATION REQUIREMENT

### A. Background

Until recently, when a sale of a business was structured as a sale of stock, the applicability of the federal securities laws was at issue. Notwithstanding the broad definitions of the term "security" contained in the Securities Act of 1933<sup>13</sup> and the Exchange Act, the Seventh, Ninth, Tenth, and Eleventh Circuits had recognized a "sale of business" exception to the Acts' coverage.<sup>14</sup> The "sale of business" doctrine provided that the sale of a controlling interest in a business by the sale of its stock is, in reality, a sale of the underlying business assets as opposed to an investment in securities. The sale of stock was viewed as merely incidental to the sale of assets. Consequently, the transaction was not subject to federal securities laws.<sup>15</sup>

10. See *infra* notes 45-125 and accompanying text.

11. See *infra* notes 126-94 and accompanying text.

12. See *infra* notes 194-99 and accompanying text.

13. 15 U.S.C. §§ 77a-aa (1984) [hereinafter Securities Act]. The Securities Act regulates securities transactions by requiring an issuer of securities to register such securities prior to public sale.

14. See, e.g., *Landreth Timber Co. v. Landreth*, 731 F.2d 1348 (9th Cir. 1984), *rev'd*, 471 U.S. 681 (1985); *Christy v. Cambron*, 710 F.2d 669 (10th Cir. 1983); *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982); *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir.), *cert. denied*, 451 U.S. 1017 (1981).

15. See, e.g., *Sutter v. Groen*, 687 F.2d 197, 199 (7th Cir. 1982); *Canfield v. Rapp & Son, Inc.*, 654 F.2d 459, 464 (7th Cir. 1981); *Frederiksen*, 637 F.2d at 1150-51; *Chandler v. Kew, Inc.*, 691 F.2d 443, 444 (10th Cir. 1977). *But see* *Seagrave Corp. v. Vista Resources, Inc.*, 696 F.2d 227, 229 (2d Cir. 1982); *Golden v. Garafalo*, 678 F.2d 1139, 1144 (2d Cir. 1982); *Coffin v. Polishing Machs., Inc.*, 596 F.2d 1202, 1204 (4th Cir.), *cert. denied*, 444 U.S. 868 (1979).

In contrast, the Second, Third, Fourth, Fifth, and Eighth Circuits rejected the sale of business exception, holding that the Acts applied whenever an instrument called "stock" was transferred.<sup>16</sup> In May, 1985, however, the Supreme Court resolved the inter-circuit conflict and rejected the sale of business doctrine in the companion cases of *Landreth Timber Co. v. Landreth*<sup>17</sup> and *Gould v. Ruefenacht*.<sup>18</sup>

### B. *The Evolution of the "Sale of Business" Doctrine*

The Supreme Court has on several occasions attempted to define whether an instrument is properly characterized as a security under the Acts.<sup>19</sup> The Supreme Court first attempted to define "security" in *Securities & Exchange Commission v. C.M. Joiner Leasing Corp.*<sup>20</sup> This decision marked the Court's support for what is known as the "literal approach" to defining a security.<sup>21</sup> The Court asserted that instruments are to be included within the definition of a security as a matter of law if they answer to the name or description of a security.<sup>22</sup> In addition, the Court stated that "we do nothing to the words of the Act; we merely accept them."<sup>23</sup> This literal approach appeared to be weakened, however, by the Court's holding in

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16. See, e.g., *Ruefenacht v. O'Halloran*, 737 F.2d 320 (3rd Cir. 1984), *aff'd*, sub nom. *Gould v. Ruefenacht*, 471 U.S. 701 (1985); *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983); *Cole v. PPG Indus.*, 680 F.2d 549 (8th Cir. 1982); *Golden*, 678 F.2d at 1139; *Coffin*, 596 F.2d at 1202.

17. 471 U.S. 681 (1985) (involving the sale of 100% of a corporation's stock).

18. 471 U.S. 701 (1985) (involving the sale of 50% of a corporation's stock).

19. See, e.g., *Gould*, 471 U.S. 701; *Landreth*, 471 U.S. 681; *Marine Bank v. Weaver*, 455 U.S. 551 (1982); *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551 (1979); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975); *Securities & Exch. Comm'n v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *Securities & Exch. Comm'n v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959); *Securities & Exch. Comm'n v. W.J. Howey Co.*, 328 U.S. 293 (1946); *Securities & Exch. Comm'n v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943).

20. 320 U.S. 344 (1943). The issue presented was whether the sale of oil lease assignments, coupled with the promise to drill exploratory wells, was a securities transaction. *Id.*

21. Note, *Removing Insecurity in Security Law Coverage: The Third Circuit Rejects the Sale-of-Business Doctrine in Ruefenacht v. O'Halloran*, 10 DEL. J. CORP. L. 97, 101 (1985).

22. *C.M. Joiner*, 320 U.S. at 351.

23. *Id.* at 355.

*Securities & Exchange Commission v. W.J. Howey Co.*<sup>24</sup> In determining whether certain transactions were investment contracts governed by the Securities Acts, the *Howey* Court applied a three prong test, otherwise known as the "economic realities" test.<sup>25</sup> The Court held that if a person invests money in a common scheme or enterprise, and is led to expect profits solely from the efforts of others, the transaction involves an investment contract which is subject to federal securities laws.<sup>26</sup>

In *United Housing Foundation, Inc. v. Forman*,<sup>27</sup> the United States Supreme Court examined whether the transfer of shares of stock in a non-profit housing cooperative was subject to protection under the securities laws.<sup>28</sup> In a bifurcated analysis, the Court first asserted that an instrument must possess the attributes commonly associated with stock before the securities laws will apply.<sup>29</sup> These commonly associated attributes are: (1) the right to receive dividends; (2) the ability to negotiate; (3) the ability to be pledged or hypothecated; (4) the conferring of voting rights; and (5) the ability to appreciate in value.<sup>30</sup> In the second part of its analysis, the *Forman* Court embraced the economic realities test advanced in *Howey* in finding that the housing cooperative stock attracted buyers only to a place to live, not to expected profits.<sup>31</sup> The *Forman* and the *Howey* decisions provided the judicial basis for the sale of business doctrine. Lower courts have followed the *Forman* decision by holding that because a purchaser of stock representing a controlling interest in a business does not

24. 328 U.S. 293 (1946). The question presented was whether an offering of citrus grove development units coupled with service contracts constituted an "investment contract" within the meaning of section 2(1) of the Exchange Act.

25. *Id.* at 301. See also Note, Landreth Timber Co. v. Landreth: *The Supreme Court's Rejection of the Sale of Business Doctrine*, 35 AM. U.L. REV. 869, 875 (1986).

26. *W.J. Howey*, 328 U.S. at 301.

27. 421 U.S. 837 (1975). In *Forman* tenants were required to purchase stock in order to obtain apartments. However, when maintenance costs increased due to increased construction costs, the tenants sued under the anti-fraud provisions of the Securities Acts. *Id.* at 842-44.

28. *Id.* at 840-42.

29. It is interesting to note that at the onset the *Forman* Court rejected a literalist application of the security laws. Specifically, the Court held that an instrument's label in and of itself will not bring an instrument within the Act's coverage. *Id.* at 848.

30. *Id.* at 851.

31. *Id.* at 851-52.

rely on the efforts of others to produce a profit, the sale is not subject to the securities laws.<sup>32</sup>

### C. Landreth — Rejection of the “Sale of Business Doctrine”

In *Landreth*, the defendants, wishing to sell their lumber business, offered one-hundred percent of their stock for sale through brokers.<sup>33</sup> Prior to the sale of the business, a portion of the mill’s facilities was destroyed by fire. By virtue of this damage the defendants modernized the business before selling it to the plaintiffs.<sup>34</sup> After the business was purchased, it failed to live up to the plaintiffs’ expectations and went into receivership. Shortly thereafter, the plaintiffs filed suit seeking rescission and damages for violations of federal securities laws.<sup>35</sup> Specifically, the plaintiffs alleged that the defendants sold unregistered securities and made material omissions and misrepresentations about the business.

From the outset the *Landreth* Court made it clear that it intended to apply the securities laws literally by stating that “[t]he starting point in every case involving construction of a statute is the language itself.”<sup>36</sup> The Court distinguished the *Howey* and *Forman* decisions, which utilized the economic reality approach, on the basis that the instruments at issue in the previous cases were atypical.<sup>37</sup> The *Landreth* Court held that if an instrument was labeled “stock” and the “stock” con-

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32. See Easley, *Recent Developments in the Sale-of-Business Doctrine: Toward a Transactional Context-Based Analysis for Federal Securities Jurisdiction*, 39 BUS. LAW. 929 (1984). See also *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir. 1981), cert. denied, 451 U.S. 1017 (1981); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977).

33. *Landreth*, 471 U.S. at 684. Ivan Landreth and his two sons were the sole shareholders in a lumber business they operated in Tonasket, Washington.

34. *Id.* Approximately 85% of the outstanding stock of the lumber business was sold to Samuel Dennis, a tax attorney, and John Bolten, a businessman. The remaining 15% was purchased by six other investors. To effect the purchase, Dennis and Bolten formed the B & D Co. which merged with the existing lumber company to form Landreth Timber Co. *Id.* at 684.

35. *Id.* Namely, the plaintiffs sought \$2,500,000 in damages. The losses resulted in part because the rebuilding costs were higher than estimated and the new equipment was incompatible with the existing mill components. *Id.*

36. *Landreth*, 471 U.S. at 685 (citing *Blue Chips Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)).

37. *Landreth*, 471 U.S. at 689-92. The unusual instruments were land sales contracts in citrus groves (*Howey*) and instruments labelled stock but bearing none of the usual characteristics (*Forman*). *Id.*

tained the attributes commonly associated with stock, then the "stock" is automatically a security regardless of the context in which it is used.<sup>38</sup> However, if the "stock" does not possess the commonly associated attributes, then a court may employ the *Howey* test to determine whether an instrument qualifies alternatively as an "investment contract."<sup>39</sup>

#### D. Impact of Landreth

The *Landreth* decision greatly reduces the significance of the *Howey* economic realities test as a method of determining whether an instrument is a "security." The *Howey* test is now reserved to bring unusual instruments under the purview of the federal securities laws.<sup>40</sup> In light of this reservation, both the Exchange Act and the Securities Act will no longer be exclusively applied to stock transfer cases which only involve passive investors.<sup>41</sup> Moreover, as a result of the *Landreth* decision, investors will enjoy increased anti-fraud protection under the Acts. The "sale of business doctrine" had preserved an investor's rights and remedies under the common law but effectively precluded recovery under the federal securities

38. *Id.* at 686. Justice Powell acknowledged that the label of an instrument alone was insufficient to trigger application of the federal securities laws. Accordingly, one must determine whether the instrument possessed the traditional attributes of stock. Justice Powell identified those attributes as being: "(i) the right to receive dividends . . . (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights . . . and (v) the capacity to appreciate in value." *Id.* (citing *Forman*, 421 U.S. at 851). It is interesting to note that the Court of Appeals for the Ninth Circuit affirmed the holding of the district court, which granted summary judgment in favor of the defendants under the rationale of the sale of business doctrine. *Landreth Timber Co. v. Landreth*, 731 F.2d 1348, 1353 (9th Cir. 1984).

39. *Landreth*, 471 U.S. at 689. Note that the plaintiffs relied upon *Tcherepnin v. Knight*, 389 U.S. 332 (1967), as well as *Marine Bank v. Weaver*, 455 U.S. 551 (1982), as support for their argument that the economic realities test should be utilized in every instance. The Court rebutted this argument by pointing out that both *Tcherepnin* and *Weaver* involved "unusual instruments that did not fit squarely within one of the enumerated specific kinds of securities listed in the definition." *Landreth*, 471 U.S. at 689-90 n.4.

40. *Landreth*, 471 U.S. at 689. See also *Prentice & Roszkowski*, *supra* note 7, at 479-99 (advancing the argument that the *Howey* test determines existence of an investment contract, not other types of securities under Acts).

41. By virtue of the requirement that one earn profits from the efforts of others under *Howey*, only passive investors were afforded protection under federal security law. Note that the respondent in *Landreth* argued that petitioner was "an active entrepreneur, who sought to 'use or consume' the business purchased . . ." *Landreth*, 471 U.S. at 690.

laws. Common law fraud was particularly restricted in the context of securities in that proof of scienter, privity, materiality, reliance, and the reasonableness of such reliance was required.<sup>42</sup> Nevertheless, proof of common law fraud may allow recovery for punitive damages, which generally are not allowed under federal securities laws.<sup>43</sup> Most importantly for purposes of this article, the *Landreth* decision has resulted in reconsideration of the analysis as to whether a business broker effecting stock transactions must register as a broker-dealer.<sup>44</sup>

### III. THE BROKER-DEALER REGISTRATION REQUIREMENT UNDER FEDERAL AND STATE LAW

#### A. Broker-Dealer Registration Under Federal Law

An examination of the history of the Exchange Act reveals that it was designed to restore investor confidence in the securities market after the stock market crash of 1929.<sup>45</sup> Subsequent amendments to the Exchange Act were directed at insuring, to the extent possible, the confidence and character of those engaged in the distribution of securities.<sup>46</sup> Section 15 of the Exchange Act was adopted as the vehicle for the Securities and Exchange Commission to oversee regulation of the securities brokerage industry.

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42. See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 154 (1972) (holding that there is no need to prove reliance in a securities fraud action under the Acts); *Securities & Exch. Comm'n v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193-95 (1963) (pointing out that there is a less stringent burden of proof under Acts' anti-fraud provisions than under a common law fraud action). See generally Prentice & Roszkowski, *supra* note 7, at 511 (discussing the substantive and procedural advantages of suing for fraud under the Acts, rather than under common law).

43. See, e.g., *Young v. Taylor*, 466 F.2d 1329, 1338 (10th Cir. 1972); *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1286 (2d Cir. 1969).

44. *But see Saunders, Lewis & Ray v. Evans, Waaler*, No. 4-86-0894 (Ill. Ct. App. 1987).

45. See *Marine Bank v. Weaver*, 455 U.S. 551, 555 (1982). See also Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607, 613 (1964); Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959); Thompson, *supra* note 7, at 234-35.

46. For examples of subsequent amendments see Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975); Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565 (1964).



Specifically, section 15(a)(1) of the Exchange Act makes it unlawful for any broker<sup>47</sup> or dealer,<sup>48</sup> except for those who exclusively engage in an intrastate business,

to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce . . . the purchase or sale of any security (other than an exempted security or commercial paper, banker's acceptances, or commercial bills) unless such broker or dealer is registered in accordance with [section 15(b)].<sup>49</sup>

### B. "Broker-Dealer" Registration Under Blue Sky Law

State legislation in the area of broker-dealer regulation has also been designed to prevent unscrupulous activity and to require a minimum level of competence for those effecting security transactions. Although blue sky legislation varies from state to state, nearly all jurisdictions require the registration of broker-dealers or agents who offer securities sales.<sup>50</sup> In addition, because most states have modeled their securities law on the 1956 Uniform Securities Act, most state securities acts are

47. See *supra* note 4.

48. See *supra* note 5.

49. See *infra* note 129. Section 2(1) of the Securities Act defines a "security" as follows:

The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (1984).

The United States Supreme Court has ruled that the definitions of security in the Securities Act of 1933 and the Exchange Act of 1934 are virtually identical and will be treated as such in dealing with the scope of the term. See *Marine Bank*, 455 U.S. at 555 n.3. Note that the 1933 and 1934 Acts' definitions of a security were amended in 1982 to include options on securities, options on certificates of deposits, options on securities indices or groups, and when traded on a national securities exchange, options on foreign currency. See Act of October 13, 1982, Pub. L. No. 97-303, § 1, 96 Stat. 1409 (1982).

50. See *supra* note 2.

similar regarding the broker-dealer or agent registration requirements.<sup>51</sup> Although this article will focus on Wisconsin's version of the Uniform Act, it will generally apply to most state laws.

Broker-dealers and agents may not engage in securities transactions within Wisconsin unless they are registered with the State of Wisconsin.<sup>52</sup> Section 551.31(1) of the Wisconsin Statutes provides in part that "[i]t is unlawful for any person to transact business in this state as a broker-dealer or agent unless so licensed under this chapter . . . ."<sup>53</sup> Persons who

51. *Id.* See also L. LONG, BLUE SKY LAW § 6.01 (rev. ed. 1987).

52. Section 551.31(1) of the Wisconsin Statutes provides that:

It is unlawful for any person to transact business in this state as a broker-dealer or agent unless so licensed under this chapter, except that a person who effects transactions in this state exclusively for the account of or exclusively in offers to sell or sales to persons specified in s. 551.23(8) is not required to be so licensed.

Wis. STAT. § 551.31(1) (1986-87).

53. *See id.*

A "person" is defined by section 551.02(10) of the Wisconsin Statutes as "an individual, a corporation, a partnership, an association, a joint stock company, a trust where the interests of the beneficiaries are evidenced by a security, an unincorporated organization, a government, a political subdivision of a government or any other entity." Wis. STAT. § 551.02(10) (1986-87).

The Wisconsin Legislature has defined a broker-dealer as any person engaged in the business of effecting transactions in securities for the account of others or for the person's own account. "Broker-dealer" does not include:

- (a) An agent;
- (b) An issuer;
- (c) A bank, savings institution or trust company, when effecting transactions for its own account or as agent under s. 551.31(5);
- (d) An executor, administrator, guardian, conservator or pledgee;
- (e) A person whose dealings in securities are limited to transactions exempt by s. 551.23(5);
- (f) A person licensed as a real estate broker under ch. 452 and whose transactions in securities are isolated transactions incidental to that business; or
- (g) The investment board; or
- (h) Other persons not within the intent of this subsection whom the commissioner by rule or order designates.

Wis. STAT. § 551.02(3) (1986-87). See also Uniform Securities Act § 201(a) (1984).

Section 551.02(2) of the Wisconsin Statutes defines an "agent" as:

any individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to effect transactions in securities. A partner, officer or director of a broker-dealer or issuer, or a person occupying a similar status or performing similar functions, is an agent if he or she is within this definition. "Agent" does not include an individual who represents an issuer in:

- (a) Effecting transactions in a security exempted by s. 551.22;
- (b) Effecting transactions exempted by s. 551.23 or 551.235, other than transactions exempted under s. 551.23(10) or (19) in which the individual re-

transact business in the state solely with licensed broker-dealers or other entities listed in section 551.23(8)<sup>54</sup> need not be licensed. However, these persons are still subject to the broker-dealer anti-fraud provisions in section 551.43.<sup>55</sup>

### *C. Brokers and Dealers Defined*

The terms "broker" and "dealer" have been broadly defined under the federal and Wisconsin statutes. Section 3(a)(4) of the Exchange Act defines a "broker" as "any person engaged in the business of effecting transactions and securities for the account of others."<sup>56</sup> Section 3(a)(5) of the Exchange Act defines "dealer" as "any person engaged in the business of buying or selling securities for his own account, through a broker or otherwise . . ."<sup>57</sup> The Wisconsin definition of broker or dealer is found in section 551.02(3) and substantially corresponds to the federal definition. However, the Wisconsin definition enumerates eight persons or entities which are not

ceives a commission or other remuneration directly or indirectly for soliciting or selling to any person in this state; or

(c) Effecting other transactions if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state.

WIS. STAT. § 551.02(2) (1986-87).

54. Pursuant to section 551.31(1), a person is not required to be licensed as a broker-dealer if he effects transactions exclusively within Wisconsin with the following persons:

(a) The issuer of the security.

(b) A bank, savings institution, credit union, trust company, insurer, broker-dealer, investment adviser or savings and loan association, if the purchaser or prospective purchaser is acting for itself or as trustee with investment control.

(c) An investment company as defined under 15 U.S.C. 80a-3 or a pension or profit-sharing trust.

(d) This state or any of its agencies or political subdivisions.

(e) The federal government or any of its agencies or instrumentalities.

(f) Any financial institution or institutional investor designated by rule or order of the commissioner.

WIS. STAT. § 551.23(8) (1986-87).

55. Section 551.43 of the Wisconsin Statutes provides that:

It is unlawful for a broker-dealer to effect in this state any transaction in, or to induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance, including any fictitious quotation. The commissioner may by rule define the terms "manipulative, deceptive or other fraudulent device or contrivance."

WIS. STAT. § 551.43 (1986-87).

56. 15 U.S.C. § 78c(a)(4) (1984).

57. 15 U.S.C. § 78c(a)(5) (1984).

considered broker-dealers, including an agent, an issuer, real estate brokers whose transactions in securities are isolated transactions incidental to the real estate business, and other persons not within the content of the section whom the Commissioner by rule or order designates.<sup>58</sup>

Another definition which is instrumental in the analysis of whether a business broker must be registered is that of "agent." While there is no definition of the term "agent" under the Acts, the term is included in part of the broader definition of dealer under section 2(12) of the Securities Act.<sup>59</sup> Under section 551.02(2) of the Wisconsin Statutes, "agent" is defined as "an individual other than a broker-dealer who represents a broker-dealer or issuer in effecting or attempting to

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58. WIS. STAT. § 551.02(3) (1986-87). Notwithstanding the potential statutory exclusion for real estate brokers contained in section 551.02(3) of the Wisconsin Statutes, it should be noted that the Wisconsin Supreme Court has held that a business opportunity broker is a real estate broker by statutory definition. *Chapman Co. v. Service Broadcasting Corp.*, 52 Wis. 2d 32, 187 N.W.2d 794 (1971). Accordingly, in Wisconsin a business opportunity broker must be licensed as a real estate broker pursuant to section 452.03 of the Wisconsin Statutes, which provides as follows:

No person may engage in or follow the business or occupation of, or advertise or hold himself or herself out as, or act temporarily or otherwise as a broker or sales person without a license. Licenses shall be granted only to persons who are competent to transact such businesses in a manner which safeguards the interests of the public, and only after satisfactory proof of the person's competence has been presented to the department. If a cemetery salesperson engages in the sale of real estate other than cemetery lots or grave spaces, the cemetery sales person shall first obtain a salesperson's license.

WIS. STAT. § 452.03 (1986-87). *But see* *Kazmer-Standish Consultants, Inc. v. Schoeffel Instruments Corp.*, 89 N.J. 286, 445 A.2d 1149 (1982).

Note that, on January 9, 1976, the staff of the Office of the Wisconsin Commissioner of Securities issued an opinion letter on the necessity of a real estate broker to obtain a securities broker-dealer license because of the scope of his business brokerage activities. The opinion letter provided that the real estate firm was licensed as a real estate broker under Chapter 452 of the Wisconsin Statutes and participated in the following activities: (1) "business brokering"; (2) making loans to the purchasers of businesses; (3) purchasing and selling stock as an integral part of the regular business of the firm; and (4) providing investment advice for client funds which were temporarily idle and over which the firm had obtained temporary custody over such funds. The staff's opinion provided that the activities set forth above required the business broker to be licensed under Chapter 551 as a securities broker-dealer. *See* 3 Blue Sky L. Rep. (CCH) ¶ 64, 859 (1976).

59. Section 2(12) of the Securities Act provides that "[t]he term 'dealer' means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. § 77 b(12) (1984) (emphasis added).

effect transactions in securities . . . .”<sup>60</sup> Because a seller of a business is not necessarily an issuer, a broker-dealer rather than an agent may effect a controlling interest stock sale.<sup>61</sup> The statutory definition of “agent” provides exclusions for certain transactions, including sales of exempt securities and some exempt transactions.<sup>62</sup> Furthermore, a real estate broker could be considered an “agent” under section 551.02(2).<sup>63</sup>

#### IV. EXEMPTIONS FROM REGISTRATION AS A BROKER OR DEALER

##### A. *Federal Law*

There are three types of exemptions from registration as a broker or dealer: (1) those arising from the market in which transactions occur; (2) those arising from the kinds of securities involved; and (3) those arising from the type of individual involved in the distribution of the securities.

##### 1. Exclusively Intrastate

Section 15(a) of the Exchange Act provides that a broker-dealer “whose business is *exclusively* intrastate and who does not make use of any facility of a national securities exchange” is exempted from the registration requirement. It should be stressed that the word “exclusively” is strictly construed. A few transactions over the course of many years or even a single transaction which crosses state lines may destroy the exemption.<sup>64</sup>

60. WIS. STAT. § 551.02(2) (1986-87).

61. This proposition is supported by the holding in *Abrams v. Love*, 254 Ill. App. 428 (1929), where the court ruled that the word “issuer” and “seller” of stock are not synonymous. *Id.* at 428. Although federal as well as state securities laws define “issuer” these definitions are circular, in that, an “issuer” is viewed as one who “issues.” Consequently, in order to have an issuer a security must have been issued. Interestingly, Article 3 of the Uniform Commercial Code defines “issue” as “the *first* delivery of an instrument to a holder or remitter.” See U.C.C. § 3-102(1)(a) (emphasis added). This definition indicates that once a “first delivery” occurs the security is issued. Accordingly, under most circumstances it seems that a sale of a business would not involve an issuer.

62. WIS. STAT. § 551.02(2)(a), (b) (1986-87).

63. *But cf.* WIS. STAT. § 551.02(3)(f) (1986-87).

64. See, e.g., *Peoples Sec. Corp. v. Securities & Exch. Comm’n*, 39 S.E.C. 641, 653 (1960), *aff’d*, 289 F.2d 268 (5th Cir. 1961); *Guon v. United States*, 285 F.2d 140, 144 (8th Cir. 1960); *In re Marks*, 25 S.E.C. 208 (1947).

The no-action letters issued by the SEC staff are consistent with a strict construction approach. The SEC staff has held that once an interstate distribution is part of a firm's business, even where a registered broker-dealer effects the distribution, the intrastate business will integrate with the interstate transactions thus destroying the exemption.<sup>65</sup> Moreover, the staff has integrated the activities of an individual selling on an intrastate basis with the activities of another individual selling in different states for the same issuer so as to deny the exemption.<sup>66</sup> The SEC staff has also refused to sanction an exemption for any officer, director, or employee of the issuer who will engage in an offering and will be paid a commission as a broker if any such individual "has previously engaged in a securities business in a state other than the state in which the issuer proposes to offer its securities."<sup>67</sup>

The staff has also held that both the broker's and issuer's businesses must be in the same state. For example, a broker-dealer would be required to register if he participated in a single offering of securities of an out-of-state issuer notwithstanding the following: (1) the broker-dealer's business was exclusively intrastate; (2) sales would be made only to residents of the broker's state; and (3) trading of the securities would be limited to the broker's state.<sup>68</sup> In addition, the staff refused to take a no-action position with respect to a registered broker-dealer who proposed to withdraw his registration and engage in solely intrastate transactions.<sup>69</sup>

## 2. Exempted Securities

Section 15(a) of the Exchange Act provides, among other things, that it is unlawful for an unregistered broker-dealer to effect any transaction or induce the purchase or sale of any security "other than an exempted security or commercial pa-

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65. Boetel & Co., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,343, at 80,794 (Aug. 30, 1971).

66. Jammer Cycle Products, Inc., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,478, at 83,332 (June 26, 1973).

67. National Educator's Group, Inc., SEC No-Action Letter (Oct. 17, 1977).

68. Fifty Fla. Corp., SEC No-Action Letter (July 31, 1973).

69. Winchester Securities Corp., SEC No-Action Letter, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,119, at 80,419 (Apr. 1, 1971).

per, bankers' acceptances, or commercial bills."<sup>70</sup> Consequently, if a broker-dealer effects any transaction in nonexempt securities,<sup>71</sup> he must register even though he may be dealing primarily in exempted securities.<sup>72</sup>

### 3. Rule 3a4-1

In 1985 the SEC adopted Rule 3a4-1 which defines the "safe harbor" circumstances under which persons associated with an issuer, such as officers, directors or employees, who participate in a distribution of the issuer's securities shall be deemed not to be brokers subject to registration.<sup>73</sup> One may qualify for safe harbor treatment if the following requirements

70. 15 U.S.C. § 78a (1984).

71. "Exempted Security" as referred to in section 15(a) of the Exchange Act is defined in section (3)(a)(12) of the Act to include, as of July 25, 1987, the following:

- (i) government securities, as defined in paragraph (42) of this subsection;
- (ii) municipal securities, as defined in paragraph (29) of this subsection;
- (iii) any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian;
- (iv) any interest or participation in a single trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation, or security is issued in connection with a qualified plan as defined in subparagraph (C) of this paragraph; and
- (v) such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this chapter which by their terms do not apply to an "exempted security" or to "exempted securities."

15 U.S.C. § 78c(12) (1987). By virtue of section 3(12)(B)(ii) of the Exchange Act, section 3(12)(A)(ii) is not deemed to be an exempted security for purposes of section 15(a) of the Exchange Act.

Pursuant to section 15(a)(2) of the Exchange Act, particular securities have been given exempt status in releases of the Commission through designations by the Treasury Department. *See, e.g.*, 17 C.F.R. § 240.15a-2 (1987) (Securities of Cooperative Apartment Houses); 17 C.F.R. § 240.15a-3 (1987) (Off-Floor Transactions by Specialists); 17 C.F.R. § 240.15a-5 (1987) (Non-Bank Lenders); 17 C.F.R. § 240.15a-4 (1987) (Temporary Exemption for Some Natural Persons).

72. *Burley & Co.*, 28 S.E.C. 126 (1948).

73. *See* 17 C.F.R. § 240.314-1(a) (1987). *See also* Persons Deemed Not To Be Brokers, Exchange Act Release No. 20,943, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,621 (May 9, 1984) (proposal); Persons Deemed Not To Be Brokers, Exchange Act Release No. 22,172, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,792 (June 27, 1985) (adopting).

are satisfied: (1) at the time of participation in the sale of the issuer's securities, the associated person may not be an affiliated person of a broker-dealer; (2) the associated person must not be subject to statutory disqualification under section 3(a)(39) of the Exchange Act; (3) the associated person may not receive any commissions or other remuneration based on transactions in securities as compensation either directly or indirectly in connection with his participation in the sale of the issuer's securities.<sup>74</sup>

Assuming the associated person satisfies the above requirements, the safe harbor may be utilized by the person if he meets any one of the three sets of conditions. The first condition relates to the associated person's restriction on participation in transactions involving offers and sales of securities: (1) to a registered broker-dealer or investment company; or to other entities such as a bank or savings and loan; or (2) that are exempted under certain Securities Act provisions; or (3) that are made pursuant to plans or agreements submitted to the vote of security holders in certain situations; or (4) that are made pursuant to certain benefit or dividend reinvestment plans for employees of an issuer or subsidiary of the issuer.<sup>75</sup>

A person may also qualify under the safe harbor rule under the second set of conditions if the person performs substantial duties on behalf of an issuer in connection with transactions in securities, provided that the person was neither a broker-dealer nor an associated person of a broker-dealer within the preceding twelve months and the person does "not participate in selling an offering of securities for *any* issuer more than once every 12 months."<sup>76</sup> The third set of conditions deals with the type of activity in which the person engages, such as communications, ministerial and clerical work.<sup>77</sup>

Compliance with the conditions of the safe harbor rule is not the exclusive means by which persons associated with an issuer may sell the issuer's securities without registering as a

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74. 17 C.F.R. § 240.3a4-1(a)(1), (2), (3) (1987).

75. 17 C.F.R. § 240.3a4-1(a)(4)(i). *See also* AFL-CIO Housing Investment Trust, SEC No-Action Letter (Apr. 31, 1986).

76. 17 C.F.R. § 240.3a4-1(a)(4)(ii) (1987).

77. 17 C.F.R. § 240.3a4-1(a)(4)(iii) (1987). *See also* Baptist Church Loan Corp., SEC No-Action Letter (Sept. 5, 1986).



broker. Accordingly, if a person or a transaction is not within the rule, counsel may look elsewhere for guidance. Specifically, the existing no-action letters relating to issuers selling interests through their own employees may provide assistance.<sup>78</sup>

### B. *Wisconsin Exemption from Registration as a Broker-Dealer or Agent*

Section 551.31(1) of the Wisconsin Statutes prohibits any person from transacting business in Wisconsin as a broker-dealer or agent unless licensed.<sup>79</sup> The section also provides an exemption from licensing for a person who effects transactions in this state exclusively for the account of or exclusively in offers to sell or sales to persons specified in section 551.23(8).<sup>80</sup> Under section 551.24(5), an unlicensed broker-dealer or agent will have the burden to establish any exclusions from the licensing requirements.<sup>81</sup> It is interesting to note that in the unpublished decision of *West Bank & Trust Co. v. Bear, Stearns & Co.*,<sup>82</sup> the Wisconsin Court of Appeals held that once a person fails to exclusively deal with persons enumerated in section 551.23(8) he loses his exemption from the licensing requirement.<sup>83</sup>

## V. SCOPE OF ACTIVITY REQUIRING REGISTRATION AS A BROKER-DEALER OR AGENT

The recurring theme under federal and state law to determine if a business broker will be required to register as a broker-dealer or agent is whether he satisfies both the "engaged in business" and "effecting transactions" requirements of a securities broker-dealer or agent. The law which has emerged in

78. See, e.g., L-K Restaurants & Hotels Inc., SEC No-Action Letter (Sept. 16, 1983); Creekside Village, Inc., SEC No-Action Letter (May 9, 1983); Argonaut Energy Corp., SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,771, at 84,087 (Mar. 14, 1974); Ballard & Cordell Corp., SEC No-Action Letters (Aug. 31 and Sept 14, 1973).

79. See *supra* note 52.

80. See *supra* note 59.

81. Section 551.24(5) of the Wisconsin Statutes provides that, "[i]n any proceeding under this chapter, the burden of proving an exemption or an exception from a definition is upon the person claiming it." WIS. STAT. § 551.24(5) (1986-87).

82. No. 81-449 (Wis. Ct. App. Oct. 13, 1981) (LEXIS, States library, Wis. file).

83. *Id.*

this area has resulted primarily from pronouncements by the SEC staff.

*A. What Constitutes "Engaged in the Business"*

The "engaged in business" requirement implies either holding oneself out as available to perform or actually performing repeated securities transactions. Although the definition of broker does not share the "regular business" language with the definition of a dealer, it appears that more than isolated transactions are required before one must register as a securities broker.<sup>84</sup> In applying the "recurrence test," the SEC in its no-action letters has uniformly held that registration is not mandated under section 15(a)(1) of the Exchange Act if a person has never participated in securities transactions and does not anticipate making any further securities offerings.<sup>85</sup> It is interesting to note, however, that courts have reached divergent conclusions as to whether an isolated security transaction results in a broker status.<sup>86</sup>

The SEC staff has stated that section 15(a) of the Exchange Act requires registration of a person who has had prior experience as a securities salesman and might become involved in future offerings.<sup>87</sup> The regularity and frequency of turnover is a decisive factor in the broker-dealer status determination. For example, a person who had repeatedly sold interests in real estate ventures to investors as part of a real estate business was held to be a "dealer" and, therefore, was required to register.<sup>88</sup> In light of this letter it is apparent that a person may be required to register as a broker-dealer although a person's securities activities neither constitute his principal business or principal source of income.

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84. See L. LOSS, *SECURITIES REGULATIONS* 1295 (2d ed. 1961).

85. See Premier Corp., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,501, at 83,386 (July 20, 1973); Ariz. - Cal. Land & Cattle Co., SEC No-Action Letter (May 31, 1973).

86. See, e.g., Owen v. Off, 36 Cal. 2d 751, 227 P.2d 457 (1951); Marble v. Clein, 55 Wash. 2d 315, 347 P.2d 830 (1959).

87. See ECC Oil Co., SEC No-Action Letter (July 13, 1973); Inland Realty Inv. Inc., SEC No-Action Letter (Apr. 20, 1973).

88. See Hofheimer, Gartlir, Gottlieb & Gross, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,098, at 82,374 (Oct. 12, 1972).

In addition, advertising by a person or entity may evidence being "engaged in business." The SEC staff has held that the utilization of advertisements to accumulate a position in a particular security will not necessarily qualify a person as a dealer if there is no repetition of the activity as to other securities.<sup>89</sup> In contrast, holding oneself out as available or interested in trading through general advertising can bring one within the "engaged in business" test.<sup>90</sup>

### B. What Constitutes "Effecting Transactions"

Typically, there are five activities related to the functions of a registered securities broker-dealer or agent which may bring one within the definition of a broker-dealer or agent: (1) acting as a finder; (2) consulting independently with an issuer; (3) channeling customers to broker-dealers; (4) sharing in broker-dealer compensation; or (5) maintaining custody or possession of customers' funds or securities.

#### 1. Finders

Generally, a finder brings together two entities interested in forming a business combination. The services of finders may vary from case to case.<sup>91</sup> If a finder merely brings the parties together with no involvement in negotiating the price or any of the other terms of the transaction, he will not be acting as a broker.<sup>92</sup> On the other hand, a finder will be deemed to be a broker if he participates in negotiations by advising on questions of value or performs other acts to facilitate the transaction.<sup>93</sup> The SEC staff has taken the position that:

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89. Joseph McCulley, SEC No Action-Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,982, at 82,110 (Aug. 2, 1972).

90. Securities & Exch. Comm'n v. Schmidt, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,202, — (S.D.N.Y. 1971).

91. See, e.g., Evans v. Riverside Int'l Raceway, 237 Cal. App. 2d 666, 47 Cal. Rptr. 187 (Dist. Ct. App. 1965).

92. See, e.g., Schaller v. Litton Indus., Inc., 307 F. Supp. 126 (E.D. Wis. 1969); Zugsmith v. Mullins, 81 Ariz. 33, 299 P.2d 629, modified, 81 Ariz. 185, 303 P.2d 261 (1956); Stoll v. Mallory, 173 Cal. App. 2d 694, 343 P.2d 970 (Dist. Ct. App. 1959); Regan v. Consolidated Bakeries, Inc., 262 Mich. 249, 247 N.W. 171 (1933).

93. See, e.g., P.W. Chapman & Co., Inc. v. Cornelius, 39 F.2d 555 (2nd Cir. 1930); Bittner v. American-Marietta Co., 162 F. Supp. 486 (E.D. Ill. 1958); Kuffler v. List,

[I]ndividuals who do nothing more than bring merger or acquisition-minded persons or entities together and do not participate in negotiations or settlements probably are not brokers or dealers . . . . On the other hand, persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities generally are deemed to be either a broker or dealer . . . .<sup>94</sup>

More recently, the SEC staff recommended that no enforcement action be taken under section 15(a) of the Exchange Act if a not-for-profit corporation, created to encourage economic development in a state by matching entrepreneurs and potential investors, did not register as a broker-dealer.<sup>95</sup> It is important to note that the corporation in question did not engage in any of the following activities:

(1) advise entrepreneurs or investors on the merits of a particular opportunity; (2) receive any fee other than requiring a nominal application fee to cover the administrative costs of the program; (3) participate in negotiating the terms of an investment; (4) hold itself out as providing any service other than an introductory "match" between the entrepreneur and the investor; (5) provide information as to how the investor and entrepreneur, once matched, would complete a transaction; or (6) handle funds or securities involved in completing the transaction.<sup>96</sup>

The SEC staff recently addressed whether a business broker was required to register as a broker under section 15(a) of the Exchange Act.<sup>97</sup> The staff did not recommend enforcement action against a business broker even though the broker

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144 F. Supp. 776 (S.D.N.Y. 1956); *Lindeman v. Textron, Inc.*, 143 F. Supp. 955 (S.D.N.Y. 1956).

94. See Henry C. Coppelt d/b/a May-Pac Management Co., SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,814, at 84,200 (Nov. 20, 1974); Ruth H. Quigley, SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,474, at 83,321 (June 14, 1973). See also Carl F. Feinstock, SEC No-Action Letter, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,749 (Mar. 2, 1979); Fullham & Co., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,186, at 82,604 (Nov. 21, 1972).

95. Venture Capital Exch., Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,310, at 76,937 (Mar. 24, 1986).

96. *Id.* See also Atlanta Economic Dev. Corp., SEC No-Action Letter (Feb. 17, 1987); University of Ark., SEC No-Action Letter (Oct. 6, 1986); Indiana Inst. for New Business Ventures, Inc., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,189, at 76,768 (Dec. 11, 1985).

97. International Business Exch. Corp., SEC No-Action Letter (Dec. 12, 1986).

entered into listing agreements with businesses to sell the assets of these companies, advertised the assets of these companies, provided information supplied by the seller to prospective buyers, assisted in negotiations by transmitting documents between parties, and collected a commission based on the selling price. In taking this position the staff noted that a business broker need not register because: (1) it had a limited role in negotiations between the seller and buyer; (2) the businesses involved were going concerns; (3) only assets were advertised; (4) transactions effected by sales of securities would involve the sale of all the equity to one buyer or a group formed without the business broker's assistance; (5) no advice was rendered by the business broker as to whether to issue securities nor did it assess the value of securities sold; (6) the compensation did not vary according to whether the form of the transaction was an asset or stock sale; and (7) the business broker did not assist the buyers in obtaining financing, except that it could, at the parties' request, provide a list of potential lenders.<sup>98</sup>

## 2. Consultants

To avoid broker-dealer status, an independent consultant must not assist or supervise the sales efforts of a securities offering. The consultant must limit his activities to advising the issuer on how to develop the offering.<sup>99</sup> In *Eastside Church Of Christ v. National Plan, Inc.*,<sup>100</sup> the court of appeals held that the evidence conclusively established that the defendant was a securities broker where the defendant: (1) assisted the issuer in doing all of the legal work concerning the offering; (2) completed all necessary printing; (3) handled all of the paper work in connection with the offering; (4) served as fiscal agent and trustee of the offering; (5) put on programs relating to the offering upon request at numerous sites; and (6) directed the sales program.<sup>101</sup>

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98. *Id.*

99. See, e.g., *P.W. Chapman & Co. v. Cornelius*, 39 F.2d 555 (2d Cir. 1930); *Irey v. Len*, 191 Cal. App. 2d 13, 12 Cal. Rptr. 403 (Dist. Ct. App. 1961).

100. 391 F.2d 357 (5th Cir.), *cert. denied sub nom.* *Church of Christ v. National Plan, Inc.*, 393 U.S. 913 (1968), *judgment for plaintiff on remand aff'd sub nom.* *McGregor Blvd. Church of Christ v. Walling*, 428 F.2d 401 (5th Cir. 1970).

101. *Eastside*, 391 F.2d 357.

The SEC staff held that a consultant retained to develop a proposed business plan of a new corporation, including the program for offering securities, need not register as a broker-dealer if it did not participate directly or indirectly in offering the securities.<sup>102</sup> Moreover, the staff has held that a firm is not a broker-dealer when a firm's services principally consist of: (1) advising the issuer on methods and procedures relative to the security issue; (2) providing necessary charter amendments and resolutions; (3) making arrangements with banks to handle the retirement of the issues; and (4) gathering information for the offering circular, drafting it, and clearing it with the state securities agency. It is noteworthy that the firm did not participate in a subsequent sales effort, nor did it train or direct any sales personnel, and its name did not appear on any of the sales literature.<sup>103</sup>

In contrast, the SEC staff concluded that registration would be required where a firm engaged in the following activities: (1) conducted a feasibility study to structure the issuance of securities; (2) prepared an outline for the issuer with recommendations relating to the issue; (3) searched out and obtained a registered broker-dealer to act as managing underwriter; (4) prepared the registration statement and handled its processing; (5) assisted broker-dealers and their representatives in analyzing and developing marketing techniques with respect to the offering; (6) provided training programs for representatives of the broker-dealers upon request; and (7) received a commission based on the size of the offering.<sup>104</sup>

### 3. Channeling

The solicitation of potential clients for the purpose of referral or "channeling" to particular broker-dealers specific mutual funds or other specific securities investments will re-

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102. Stamp Collector Ass'n, Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,562, at 81,209 (Oct. 22, 1971).

103. Christian Bonds, Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,407, at 80,900 (Aug. 27, 1971). *See also* Church Funding Corp., SEC No-Action Letter (Nov. 15, 1979).

104. Gunnar, Burkhardt, Armstrong & Assocs., SEC No-Action Letter (Nov. 28, 1975).

quire the registration of the solicitor as a broker.<sup>105</sup> The SEC staff has concluded that a direct mail service by which selected persons would be informed that a specific broker-dealer or mutual fund representative wished to contact them would establish the solicitation of customers so as to fall within the definition of a broker.<sup>106</sup> The channeling concept has been extended to require registration by one who invites persons to complimentary dinner-seminars where no sales efforts are made, but at which investment topics are discussed and the sales representatives of broker-dealers are arranged to be present.<sup>107</sup> Moreover, the SEC staff has asserted that a restaurant which proposed a ticker tape and telephone operation which would make information on exchange transactions available to diners and would furnish free telephone lines to brokerage firms would be required to register under section 15(a) of the Exchange Act.<sup>108</sup>

Recently, the SEC staff concluded that registration was not required by tax-preparers and accountants who referred prospective clients to a registered investment adviser for a referral fee based on the size of the referred account.<sup>109</sup> The staff noted that the sole function of the preparers and the accountants was to introduce their customers to the investment adviser. In addition, the preparers and accountants indicated that only the investment advisors could elaborate on the various investment alternatives available.<sup>110</sup>

#### 4. Sharing Compensation

Whether a person is receiving any portion of the compensation realized by a broker-dealer is another factor in determining whether a person is indirectly "effecting" securities transactions. For example, the SEC staff has taken the position that accountants who charge a fixed fee to their clients for

105. See Charles J. Hecht, SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,749, at 81,559 (Feb. 29, 1972).

106. See John T. Goggin, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,285, at 82,813 (Jan 8, 1973).

107. See Leonard-Trapp & Assoc. Consultants, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,971, at 82,093 (July 25, 1972).

108. See George T. Baylor, SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,390, at 80,875 (Aug. 6, 1971).

109. Redmond Assoc., SEC No-Action Letter (Dec. 11, 1985).

110. *Id.*

financial planning, including specific securities purchase recommendations, and receive transaction-based compensation from the selling broker-dealer will not be required to register if they rebate such compensation in full to their clients.<sup>111</sup> In contrast, registration was required in the absence of any compensation where the solicitor was a disability insurance firm which recommended that the insurance proceeds received by its disabled clients be invested in a particular mutual fund.<sup>112</sup> This case may be unique in that it involved a heightened concern over investor protection.

In determining whether a person is a broker-dealer, the SEC staff has also examined whether the compensation is fixed as opposed to being transaction-based.<sup>113</sup> The SEC has concluded that attorneys, accountants, insurance brokers, and financial service organizations "who for a fee assist promoters or other issuers in the sale of securities" are considered to be brokers if they have been "retained by an issuer specifically for the purpose of selling securities to the public and generally receive transaction-based compensation."<sup>114</sup> Recently, however, the SEC staff held that registration was not required where a company received negotiated fees relating to "the overall size of the financing that the client wish[ed] to arrange, [which] generally [would] not be payable unless the financing close[d] successfully."<sup>115</sup> Interestingly, the same company could on occasion participate in discussions prior to the closing with the issuer and the underwriter by explaining, defending or negotiating proposals adopted by its client. This no-action letter appears to be inconsistent with the aforementioned policy of the Commission and the previously discussed letters. Nevertheless, the SEC staff's conclusion that independent consultants were not required to register as broker-dealers to develop contacts with public employer representa-

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111. *Biscotte & Co. Certified Public Accountants*, SEC No-Action Letter (Nov. 29, 1985).

112. *Contrails Growth Fund, Inc.*, SEC No-Action Letter (Jan. 31, 1972).

113. *See, e.g., Henry C. Coppelt d/b/a May-Pac Management Co.*, SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,814, at 84,200 (May 13, 1974); *Fulham & Co.*, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,186, at 82,604 (Nov. 21, 1972).

114. *Persons Deemed Not To Be Brokers*, Exchange Act Release No. 20,943, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,621, at 86,817 (May 9, 1984).

115. *Dominion Resources, Inc.*, SEC No-Action Letter (July 23, 1985).



tives for the possible sale of annuity plans was consistent with the staff's previous policies because the consultants were not paid transaction-based compensation but were paid a fixed annual fee.<sup>116</sup>

## 5. Custody or Possession of Funds

As a general rule, the furnishing of purely clerical or ministerial services relating to the broker-dealer function will not bring one within the definition of a broker-dealer or agent.<sup>117</sup> Specifically, the rule with respect to custody of a customer's fund is that "[g]enerally speaking, . . . if a company acts as agent for an issuer or investor in connection with the purchase or sale of securities, or maintains custody or possession of funds or securities at any stage of a securities transaction, it would . . . be subject to the broker-dealer regulatory requirements . . . ."<sup>118</sup> The staff has also phrased the above rule so that the services cannot go "beyond those of a purely clerical or ministerial nature."<sup>119</sup> However, the SEC staff has determined that simply processing investor applications, developing data processing systems for use in the creation and maintenance of shareholder records for mutual funds, and acting as a shareholder service agent with temporary custody but not control over customer checks made payable to others did not warrant registration.<sup>120</sup> Moreover, the staff recently asserted that an entity should register as a broker-dealer if it acted to aggregate funds so as to meet the minimum invest-

116. H.C. Copeland & Assoc. Equities, Inc., SEC No-Action Letter (Mar. 9, 1982).

117. See, e.g., Boston Mut. Life Ins. Co., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,650 (Dec. 13, 1971); United Benefit Life Ins. Co., SEC No-Action Letter, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,059, at 80,383 (Feb. 25, 1971).

118. The Stallion Fund, Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,499, at 81,086 (Sept. 13, 1971). See also ESE Stock Transfer Corp., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,452, at 80,987 (Sept. 13, 1971).

119. Jefferson Serv. Corp., SEC No-Action Letter, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,114, at 77,828 (Oct. 5, 1981); Clearing Servs., Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,715, at 81,508 (Jan. 3, 1972).

120. See Applied Fin. Sys., Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,385, at 80,865 (Aug. 27, 1971).

ment amount for the purchase of money market securities of a particular issuer.<sup>121</sup>

### C. *Business Broker as an "Underwriter"*

The conduct of a business broker may bring him within the definition of an "underwriter" if his services result in "participation in the undertaking rather than that of a mere interest in it."<sup>122</sup> Section 2(11) of the Securities Act of 1933 defines underwriter to include "any person who . . . offers or sells for an issuer in connection with the distribution of any security, or participates or has a direct or indirect participation in any such undertaking . . . ."<sup>123</sup> Thus, a business broker may be deemed an underwriter if his services include effecting a public distribution of securities or the solicitation of indications of interest to purchase securities.

In a 1974 no-action letter, the SEC took a no-action position on a finder whose activities included introducing parties to negotiate acquisitions of businesses or assets.<sup>124</sup> The finder did not become involved in the negotiations of parties or evaluation of the proposed transaction. However, the SEC indicated that if the finder's business included solicitation of investors' indications of interest in a security, the finder would be deemed an underwriter as defined in section 2(11) of the Securities Act.<sup>125</sup>

## VI. CONSEQUENCES OF EFFECTING SECURITIES TRANSACTIONS WITHOUT A BROKER-DEALER'S LICENSE

The sale of a security by a unregistered broker-dealer or agent may result in both civil and criminal liability for the broker-dealer or agent and the issuer<sup>126</sup> or seller of stock. The

121. Massachusetts Businessman's Assoc., SEC No-Action Letter, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 74,114, at 77,828 (Oct. 5, 1981).

122. H.R. REP. NO. 152, 73d Cong., 1st Sess. 24 (1933).

123. 15 U.S.C. § 77b(11) (1984).

124. F. Willard Griffith, II, SEC No-Action Letter, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,994, at 84,561 (Aug. 6, 1974).

125. *Id.*

126. Under the Exchange Act of 1934 the term "issuer" is defined as:

[A]ny person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collat-

civil remedies available to a purchaser of securities from an unlicensed broker-dealer may be classified into three categories: remedies at common law; express or implied remedies under federal law; and express or implied remedies under state blue sky laws. In addition to the civil remedies, the Securities and Exchange Commission as well as the Commissioner of Securities for the State of Wisconsin are empowered to obtain injunctions against unregistered persons engaging in securities brokerage activity.<sup>127</sup> Moreover, the Securities and Exchange Commission and the Wisconsin Commissioner of Securities

eral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is, or is to be, used.

15 U.S.C. § 78c(a)(8) (1984). The Wisconsin Statutes defines an "issuer" as:

[A]ny person who issues or proposes to issue any security or any promoter who acts for an issuer to be formed, except:

(a) With respect to certificates of deposit or trust certificates, "issuer" means the person performing the acts and assuming the duties of depositor, manager or trustee pursuant to the provisions of the trust or other instrument under which the security is issued; and

(b) With respect to certificates of interest or participation in oil, gas or mining titles or leases, "issuer" means the owner of any such title or lease who creates fractional interests therein for purposes of sale.

WIS. STAT. § 551.02(8) (1986-87).

127. Section 21(e) of the Exchange Act provides:

Upon application of the Commission the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall also have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this title, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, and the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this title, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

15 U.S.C. § 78u(e) (1984).

Additionally, section 551.60(2)(b) of the Wisconsin Statutes provides that:

may impose criminal sanctions for unlicensed securities brokerage activity.<sup>128</sup> This section will elaborate on the statutory remedies under federal and Wisconsin law.

### A. Federal Law

#### 1. Broker-Dealer Civil Liability

The courts are divided about whether there is an implied right of recovery under the Exchange Act for buyers or sellers of securities when a broker or dealer fails to register under section 15(a) of the Act. Section 15(a), by its terms, does not mandate express liability for its violation.<sup>129</sup> Hence, courts have generally held that there is no private right of action for violations of section 15 of the Exchange Act.<sup>130</sup> Despite the general rule, a contrary result was reached in *Opper v. Hancock Securities Corp.*<sup>131</sup> However, the *Opper* decision was rendered prior to the enunciation of the test for an implied cause of action by the United States Supreme Court in *Cort v. Ash*.<sup>132</sup> As a result, the holding in *Opper* is no longer controlling.

If the commissioner has reason to believe that any security is being or has been offered or sold in this state by any unlicensed person in violation of this chapter or any rule or order hereunder, the commissioner may by order summarily prohibit such person from further offers or sales of securities in this state until licensed under this chapter.

WIS. STAT. § 551.60(2)(b) (1986-87).

128. See *infra* notes 140-41, 183-99.

129. Section 15(a) of the Exchange Act provides:

It shall be unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with subsection (b) of this section.

15 U.S.C. § 78a(1) (1984).

130. See, e.g., *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530 (9th Cir. 1984); *Securities & Exch. Comm'n v. Seaboard Corp.*, 677 F.2d 1301 (9th Cir. 1982); *Rhoades v. Powell*, 644 F. Supp. 645 (E.D. Cal. 1986); *Bull v. American Bank & Trust Co.*, 641 F. Supp. 62 (E.D. Pa. 1986); *Shotto v. Laub*, 632 F. Supp. 516 (D. Md. 1986); *Olsen v. Paine Webber, Jackson & Curtis, Inc.*, 623 F. Supp. 17 (M.D. Fla. 1985).

131. 250 F. Supp. 668 (S.D.N.Y.), *aff'd per curiam*, 367 F.2d 157 (2d Cir. 1966).

132. 422 U.S. 66 (1975).

By contrast, courts have held that a private cause of action can be founded upon section 29(b) of the Act. Section 29(b) provides:

[e]very contract made in violation of any provision of [the Act] . . . and every contract . . . the performance of which involves the violation of . . . any provision of [the Act] . . . shall be void . . . as regards the rights of any person who, in violation of any such provision . . . shall have made or engaged in the performance of any such contract.<sup>133</sup>

Section 29(b) of the Exchange Act permits a party to a contract to seek rescission if he can show that "(1) the contract involved a 'prohibited transaction' [under the Exchange Act], (2) he is in contractual privity with the defendant, and (3) he is 'in the class of persons the Act was designed to protect.'" <sup>134</sup> Notwithstanding the courts' refusal to imply a private cause of action under section 15(a), courts have held that section 29(b) creates an implied private cause of action for rescission or similar equitable relief.<sup>135</sup> Consequently, a section 29(b) claim can be based on an Exchange Act provision that does not contain private rights of action,<sup>136</sup> but the ordinary equitable defenses of estoppel, waiver, and laches are applicable. In *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*,<sup>137</sup> an unlicensed broker who performed work as promised was entitled to retain a fee paid for services he had performed because he was not unjustly enriched. However, the broker was not entitled to any fees as yet unpaid.<sup>138</sup> Notably, it has been asserted that section 29(b) does not create an implied private right of action for money damages.<sup>139</sup>

133. 15 U.S.C. § 78cc(b) (1984).

134. See, *Regional Properties, Inc. v. Financial & Real Estate Consulting Co.*, 678 F.2d 552, 559 (5th Cir. 1982).

135. *Id.* at 561; *Eastside Church of Christ v. National Plan, Inc.*, 391 F.2d 357 (5th Cir.), cert. denied sub nom. *Church of Christ v. National Plan, Inc.*, 393 U.S. 913 (1968), judgment for plaintiff on remand aff'd sub nom. *McGregor Blvd. Church of Christ v. Walling*, 428 F.2d 401 (5th Cir. 1970); *Rhoades v. Powell*, 644 F. Supp. 645 (E.D. Cal. 1986); *Davis v. AVCO Corp.*, 371 F. Supp. 782, 789 (N.D. Ohio 1974).

136. See *supra* note 135.

137. 678 F.2d 552 (5th Cir. 1982).

138. *Id.* at 564.

139. See *Rhoades*, 644 F. Supp. at 662.

## 2. Broker-Dealer Criminal Liability

Under certain circumstances, the Commission has sought and obtained criminal convictions for the failure of a broker-dealer to register. In *Guon v. United States*,<sup>140</sup> the defendant, a licensed broker in North Dakota, was convicted and placed on probation for violating section 15 of the Exchange Act by receiving securities in South Dakota in payment for a sale of stock entered into in North Dakota. The court of appeals concluded the jury was warranted in finding that the receipt of the marketable securities in South Dakota constituted a sale even though the agreement to purchase the stock was entered into in North Dakota.<sup>141</sup>

## 3. Injunctive Relief

In determining whether injunctive relief is warranted under the federal securities laws, courts have examined whether "there is a reasonable likelihood of further violation in the future."<sup>142</sup> Addressing this issue in the context of a broker-dealer's failure to register, a district court examined the following factors: (1) the likelihood of future violations; (2) the degree of scienter involved; (3) the sincerity of defendant's assurances against future violations; (4) the isolated or recurrent nature of the infraction; (5) defendant's recognition of the wrongful nature of his conduct; and (6) the likelihood, because of defendant's professional occupation, that future violations might occur.<sup>143</sup> Given the unregistered broker's history of securities law violations, the court granted a permanent injunction.<sup>144</sup>

Although the degree of scienter may be a factor as to whether an injunction should be issued, it has been held in a case involving a claim for injunctive relief, that section 15(a)(1) contains no language from which a scienter require-

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140. 285 F.2d 140 (8th Cir. 1960).

141. *Id.* at 144.

142. *Securities & Exch. Comm'n v. Monarch Fund*, 608 F.2d 938, 943 (2d Cir. 1979).

143. *Securities & Exch. Comm'n v. Hansen*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,426 (S.D.N.Y. 1984).

144. *Id.*

ment may be derived.<sup>145</sup> Courts have also enjoined a person from advertising when such conduct would cause the person to qualify as a broker-dealer. For example, a person who advertised in a newspaper with interstate circulation that he could save customers seventy percent on their brokerage commissions and that no commissions would be charged if the customer maintained a \$500 balance in his account was enjoined for not registering as a broker-dealer.<sup>146</sup>

#### 4. Denial, Suspension, or Revocation

Section 15(b)(4) of the Exchange Act sets forth the Commission's authority to institute disciplinary proceedings against broker-dealers.<sup>147</sup> Under this section the Commission may order any of the following for a wilful failure to register: (1) censure; (2) limitations on activities, functions or operations; (3) suspension of registration for a period not to exceed twelve months; and (4) revocation of registration. In addition, the Commission may order any of the above if one is permanently or temporarily enjoined from acting as a broker-dealer.<sup>148</sup> The Commission also has the authority to suspend the registration of a broker-dealer pending a final determination of whether the registration should be revoked.<sup>149</sup>

145. Securities & Exch. Comm'n v. National Executive Planners, Ltd., 503 F. Supp. 1066 (M.D.N.C. 1980).

146. Securities & Exch. Comm'n v. Schmidt, [1971-72 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,202 (S.D.N.Y. 1971). For additional cases where injunctive relief was sought and granted see the following: Los Angeles Trust Deed & Mortgage Exch. v. Securities & Exch. Comm'n, 285 F.2d 162 (1961); Securities & Exch. Comm'n v. Western Gold, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,784 (S.D. Fla. 1986); Securities & Exch. Comm'n v. Century Inv. Transfer Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,232 (S.D.N.Y. 1971).

147. 15 U.S.C. § 78o(b)(4)(A) (1984). Registration was denied to an unregistered broker-dealer who sold unregistered securities and failed to disclose material facts about the newly organized company in Whitehall Corp., SEC No-Action Letter, [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,573, at 80,220 (Apr. 2, 1958). See also Koza, d/b/a Chester R. Koza & Co., [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,706, at 80,646 (June 28, 1960). In Kauma Inv. Corp., Exchange Act Release No. 9743, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,970, at 82,092 (Aug. 28, 1972), the Commission suspended a broker-dealer's registration for six months for violating section 15(a) of the Exchange Act and section 5(a) of the Securities Act.

148. Exchange Act § 15(b)(4)(C), 15 U.S.C. § 78o(4)(c) (1984).

149. Exchange Act § 15(b)(5), 15 U.S.C. § 78o(5) (1984).

Moreover, under section 15(b)(6) of the Exchange Act, the Commission has the authority to institute proceedings against an individual without involving the firm with which the person is associated.<sup>150</sup> Under this provision the Commission may order, among other things, a bar from association. Under all of these sections the broker-dealer or associated person must receive notice and an opportunity for a hearing.

## 5. Liability of Issuer or Seller

As previously stated, a purchaser of securities may seek rescission under section 29(b) of the Exchange Act.<sup>151</sup> Thus, a rescission action under section 29(b) based upon a section 15(a) violation will have a greater impact on a seller or an issuer than the broker-dealer if it results in the business sale being voided. Although a purchaser of securities can obtain equitable relief against an issuer or seller, it is extremely doubtful that money damages can be obtained.<sup>152</sup> Moreover, given the absence of an implied right of action under section 15(a), it is unlikely that a purchaser of securities could rely on section 20(a)<sup>153</sup> of the Exchange Act to impose liability on a seller of a business. Section 20(a) provides that a controlling person may be jointly and severally liable with the controlled person for securities violations under certain circumstances. However, the common law action of *respondeat superior* may be available to a purchaser of securities against a seller or issuer if an unlicensed broker-dealer was engaged to sell a business.<sup>154</sup> Finally, although no implied cause of action under

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150. 15 U.S.C. § 78o(b)(6) (1984).

151. See *supra* notes 133-35.

152. See *Rhoades v. Powell*, 644 F. Supp. 645, 662 (E.D. Cal. 1986).

153. Section 20(a) of the Exchange Act provides as follows:

Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

15 U.S.C. § 78t(a) (1984). See also § 15 U.S.C. § 780 (1984). Note that courts generally construe section 15 and section 20 as if they were the same. See *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980).

154. The adoption of sections 15 and 20(a) by Congress has created an issue as to whether these sections supplant or supplement the application of the common law principles of *respondeat superior*. The circuit courts that have considered this issue are in



section 15(a) exists, the Commission is not precluded from enjoining the issuer or bringing criminal sanctions against the issuer for employing an unregistered broker-dealer.

### B. *Wisconsin Uniform Securities Act*

A business broker who satisfies the statutory definition of broker-dealer or agent, but who does not register as such in Wisconsin, violates section 551.31(1) of the Wisconsin Uniform Securities Act and is subject to liability under section 551.59.<sup>155</sup> In addition, if any security is offered or sold by an unlicensed broker-dealer or agent, then liability may also be found on the part of all persons involved in the offer or sale of that security, including the issuer or seller of a business.<sup>156</sup>

disagreement, and the Supreme Court has never addressed the issue. *Compare* *Holloway v. Howard*, 536 F.2d 690 (6th Cir. 1976); *Securities & Exch. Comm'n v. Management Dynamics, Inc.*, 515 F.2d 801 (2d Cir. 1975); *Fey v. Walston & Co.*, 493 F.2d 1036 (7th Cir. 1974) *with* *Rochez Bros. v. Rhoades*, 527 F.2d 891 (3d Cir. 1975), *cert. denied*, 425 U.S. 993 (1976); *and* *Lewis v. Walston & Co.*, 487 F.2d 617 (5th Cir. 1973). However, assuming that a common law action can be asserted against an employee (broker-dealer) as a pendent claim, it should be possible to hold an employee liable under the theory of *respondeat superior*. See *Henricksen v. Henricksen*, 640 F.2d 880 (7th Cir. 1981).

155. Section § 551.59(1)(a) provides:

Any person who offers or sells a security in violation of s. 551.21, 551.31, 551.41 or 551.55 or any rule relating thereto, or any condition imposed under s. 551.26 or 551.27 or any order under this chapter of which the person has notice is liable to the person purchasing the security from him or her. The person purchasing the security may sue either at law or in equity to recover the consideration paid for the security, together with interest at the legal rate under s. 138.04 from the date of payment, and reasonable attorney fees, less the amount of any income received on the security, upon the tender of the security, or for damages if the person no longer owns the security. Damages are the amount that would be recoverable upon a tender less the value of the security when the purchaser disposed of it and interest at the legal rate under s. 138.04 from the date of disposition. Tender shall require only notice of willingness to exchange the security for the amount specified. Any notice may be given by service as in civil actions or by certified mail addressed to the last-known address of the person liable.

WIS. STAT. § 551.59(1)(a) (1986-87).

156. Wisconsin Statutes section 551.59(4) (1986-87) provides that:

Every person who directly or indirectly controls a person liable under sub. (1), (2) or (3), every partner, principal executive officer or director of such person, every person occupying a similar status or performing similar functions, every employe of such person who materially aids in the act or transaction constituting the violation, and every broker-dealer or agent who materially aids in the act or transaction constituting the violation, are also liable jointly and severally with and to the same extent as such person, unless the person liable hereun-

This section will summarize the potential civil liability of broker-dealers and agents, followed by a discussion of the liability problems germane to issuers or sellers of securities.

### 1. Civil Liability of an Unlicensed Broker-Dealer or Agent

A purchaser of securities has a right of rescission pursuant to section 551.59(1) of the Wisconsin Statutes in that the purchaser may recover the consideration paid for the security plus interest at the legal rate and attorney fees upon the tender of the security.<sup>157</sup> Furthermore, if the security has been resold, damages may be imposed equal to the consideration paid plus interest less the value received upon the sale of security plus interest. In order for the civil liability section of the Wisconsin law to apply, the plaintiff must allege and prove that the defendant was a person, firm, or agent unregistered under section 551.31. The statute of limitations under section 551.59(5) is three years after the act or transaction constituting the violation.<sup>158</sup>

Although the unpublished opinion by the Wisconsin Court of Appeals in *West Bank & Trust v. Bear, Stearns & Co.*,<sup>159</sup> has no precedential value, it does provide some guidance as to how the Wisconsin courts will interpret the civil liability provisions of the Wisconsin Uniform Securities Act. In *West Bank & Trust* the court held, in reference to the Wisconsin Uniform Securities Act, that "[t]he scope of the Act relates to sales, offers to sell, and offers to purchase made or accepted in Wisconsin. An individual's residence is irrelevant to whether that individual may recover for civil liabilities provided in sec. 551.59."<sup>160</sup> Furthermore, the court stated that "[o]nce a potential licensee broke the exclusivity of his activity, he lost his [institutional] exemption to the licensing requirement."<sup>161</sup>

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der proves that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

WIS. STAT. § 551.59(4) (1986-87).

157. See *supra* note 154.

158. See WIS. STAT. § 151.59(5) (1986-87).

159. No. 81-449 (Wis. Ct. App. Oct. 13, 1981) (LEXIS, States library, Wis. file).

160. *Id.* at 5.

161. *Id.* at 7.

Accordingly, one offer or sale can constitute a violation of the licensing requirements with resultant liability.

In addition to liability for a violation of section 551.31(1), an agent may also incur liability under section 551.31(2).<sup>162</sup> This statute prohibits an agent from representing more than one broker-dealer or issuer at any one time unless the broker-dealers are affiliated by direct or indirect control.<sup>163</sup>

Similarly, a broker-dealer may be liable under section 551.31(2) which makes it unlawful for any broker-dealer to employ an unlicensed agent. Moreover, section 551.59(4) provides that "[e]very person who directly or indirectly controls a person liable under sub. (1), (2) or (3), . . . [is] also liable jointly and severally with and to the same extent as such person . . . ."<sup>164</sup> Section 551.59(1) specifically includes violations of section 551.31 of the Wisconsin Statutes. Thus, liability could be imposed upon a broker-dealer if the employed agent also represents another broker-dealer, issuer or seller of stock unless such parties are affiliated by direct or common control.<sup>165</sup>

Moreover, section 551.31(6) of the Wisconsin Statutes states that it is unlawful for any licensed broker-dealer or agent to transact business in Wisconsin if the licensee is in violation of this chapter, or any rule under this chapter, of which the licensee has notice or if the information contained in a license application is incomplete, false or misleading.<sup>166</sup>

162. Section § 551.31(2) of the Wisconsin Statutes provides that:

It is unlawful for any broker-dealer or issuer to employ an agent to represent it in this state unless the agent is licensed for that broker-dealer or issuer or the agent is excluded from the licensing requirement under sub. (1). No agent may at any time represent more than one broker-dealer or issuer, except an agent may represent licensed broker-dealers or issuers of securities registered under this chapter, or both, who are affiliated by direct or indirect common control. When an agent terminates employment with a broker-dealer or issuer, or terminates those activities which make that individual an agent, or transfers employment between licensed broker-dealers, the agent, the broker-dealer or the issuer shall promptly file a notice in accordance with rules adopted by the commissioner.

Wis. STAT. § 551.59(4) (1986-87).

163. *Id.*

164. *See* Wis. STAT. § 551.59(4) (1986-87).

165. *See id.* *See also* Wis. STAT. § 551.31(2) (1986-87).

166. Section § 551.31(6) of the Wisconsin Statutes provides as follows:

It is unlawful for any licensed broker-dealer, agent or investment adviser, or any person directly or indirectly controlling a licensed broker-dealer or invest-

## 2. Civil Liability of an Issuer or Seller

According to Wisconsin Statutes sections 551.31(1) and 551.59(4), an issuer or seller of stock may be jointly and severally liable if a plaintiff successfully argues that a business broker controlled an unlicensed broker-dealer who is transacting business in this state. An issuer or seller of stock may also be held jointly and severally liable with a broker-dealer or agent under sections 551.59(4) and 551.31(6) if it has direct or indirect control over a licensed broker-dealer or agent that transacts business in this state in violation of any of the following: (1) Chapter 551; (2) any rule under Chapter 551; (3) any order under Chapter 551 that the licensee or the controlling person has notice of. Additionally, liability could be imposed if the information contained in the licensee's application is incomplete in any material respect, misleading about any material fact, or false.<sup>167</sup>

According to section 551.59(4) an issuer, like a broker-dealer, can also be liable if it employs an unlicensed agent to represent it in Wisconsin.<sup>168</sup> Joint and several liability can also be imposed upon an issuer, as well as a broker-dealer, for employing a licensed agent who represents more than one broker-dealer or issuer, unless the broker-dealer(s) or issuer(s) are affiliated by direct or indirect common control.<sup>169</sup> For this reason, both a person employing an agent and the agent himself should carefully examine the employment status of the agent to insure that the agent is not involved in a dual employment situation.

An issuer or seller of securities may also incur liability through the loss of a state transactional exemption. Section 551.21(1) provides that any person who offers or sells any security in this state may incur liability unless the security is registered under Chapter 551, or the security or the transac-

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ment adviser, to transact business in this state if the licensee is in violation of this chapter, or any rule under this chapter, or any order under this chapter of which the licensee or person has notice, or if the information contained the licensee's or person's application for license, as of the date of such transactions, is incomplete in any material respect or is false or misleading with respect to any material fact.

WIS. STAT. § 551.31(6) (1986-87).

167. *See supra* notes 157, 160.

168. *See* WIS. STAT. § 551.59(4) (1986-87).

169. *Id.* *See also* WIS. STAT. § 551.31(2) (1986-87).

tion is exempt under sections 551.22, 551.23 or 551.235.<sup>170</sup> The registration exemptions frequently relied upon by sellers of stock representing a controlling interest in a company and issuers are sections 551.23(1),<sup>171</sup> 551.23(10),<sup>172</sup> 551.23(11)<sup>173</sup> and 551.23(19).<sup>174</sup> Section 551.23(1) provides that any iso-

170. WIS. STAT. § 551.21(1) (1986-87).

171. Section 551.23(1) of the Wisconsin Statutes provides that “[a]ny isolated nonissuer transaction, whether effected through a broker-dealer or not” is exempt. WIS. STAT. § 551.23(1) (1986-87).

172. Section 551.23(10) of the Wisconsin Statutes reads as follows:

Any offer or sale of its securities by an issuer having its principal office in this state, if the aggregate number of persons holding directly or indirectly all of the issuer's securities, after the securities to be issued are sold, does not exceed 15, exclusive of persons under sub. (8), if no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state, except to broker-dealers and agents licensed in this state, and if no advertising is published unless it has been permitted by the commissioner.

WIS. STAT. § 551.23(10) (1986-87).

173. Section 551.23(11) of the Wisconsin Statutes reads as follows:

(a) Any transaction pursuant to an offer directed by the offeror to not more than 10 persons in this state, excluding persons exempt under sub. (8) but including persons exempt under sub. (10), during any period of 12 consecutive months, whether or not the offeror or any of the offerees is then present in this state, if the offeror reasonably believes that all persons in this state are purchasing for investment, and no commission or other remuneration is paid or given directly or indirectly for soliciting any person in this state other than those exempt by sub. (8).

(b) The commissioner may by rule or order, as to any security or transaction or any type of security or transaction, withdraw or further condition this exemption, or increase or decrease the number of offerees permitted, or waive the conditions in par. (a), and may require reports of sales under this exemption.

See WIS. STAT. 551.23(11) (1986-87).

174. The full text of section 551.23(19) provides as follows:

(a) Any offer or sale of securities made in reliance on the exemptions provided by Rule 505 or 506 of Regulation D under the securities act of 1933 and the conditions and definitions provided by Rules 501 to 503 thereunder, if the offer or sale also satisfies the additional conditions and limitations in pars. (b) to (f).

(b) No commission or other remuneration may be paid or given, directly or indirectly, to any person for soliciting or selling to any person in this state in reliance on the exemption under par. (a), except to broker-dealers and agents licensed in this state.

(c) 1. Unless the cause for disqualification is waived under subd. 2, no exemption under par. (a) is available for the securities of an issuer unless the issuer did not know and in the exercise of reasonable care could not have known that any of the following apply to any of the persons described in Rule 252(c) to (f) of Regulation A under the securities act of 1933:

a. The person has filed a registration statement which is the subject of an effective order entered against the issuer, its officers, directors, general partners, controlling persons or affiliates thereof, pursuant to any state's law within 5

lated nonissuer transaction is exempt from securities registration. Arguably, a sale of a controlling interest in a business is

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years before the filing of a notice required under par. (d) denying effectiveness to, or suspending or revoking the effectiveness of, the registration statement.

b. The person has been convicted of any felony or misdemeanor in connection with the offer, sale or purchase of any security or franchise, or any felony involving fraud or deceit, including but not limited to forgery, embezzlement, obtaining money under false pretenses, larceny or conspiracy to defraud.

c. The person is subject to an effective administrative order or judgment entered by a state securities administrator within 5 years before the filing of a notice required under par. (d), which prohibits, denies or revokes the use of any exemption from securities registration, which prohibits the transaction of business by the person as a broker-dealer or agent, or which is based on fraud, deceit, an untrue statement of a material fact or an omission to state a material fact.

d. The person is subject to any order, judgment or decree of any court entered within 5 years before the filing of a notice required under par. (d), temporarily, preliminarily or permanently restraining or enjoining the person from engaging in or continuing any conduct or practice in connection with the offer, sale or purchase of any security, or the making of any false filing with any state.

2.a. Any disqualification under this paragraph involving a broker-dealer or agent is waived if the broker-dealer or agent is or continues to be licensed in this state as a broker-dealer or agent after notifying the commissioner of the act or event causing disqualification.

b. The commissioner may waive any disqualification under this paragraph upon a showing of good cause that it is not necessary under the circumstances that use of the exemption be denied.

(d) Not later than the earlier of the date on which the first use of an offering document or the first sale is made in this state in reliance on the exemption under par. (a), there is filed with the commissioner a notice comprised of offering material in compliance with the requirements of Rule 502 of Regulation D under the securities act of 1933, a completed Form D as prescribed by Rule 503 of Regulation D under the securities act of 1933, and a fee of \$200. Material amendments to the offering document shall be filed with the commissioner not later than the date of their first use in this state.

(e)1. As to all sales in this state, the issuer shall reasonably believe immediately before making any sale that:

a. The investment is suitable for the purchaser; and

b. The purchaser, either alone or with the purchaser's representative, has such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of the prospective investment.

2. The failure to satisfy the conditions of subd. 1 as to a purchaser shall not affect the availability of the exemption under par. (a) as to other purchasers.

(f) The commissioner may, by order, increase the number of purchasers or waive any other conditions of the exemption under par. (a) for a particular offering. The commissioner shall not require the filing of advertising used in connection with offers or sales in reliance on the exemption. The exemption may be revoked by order of the commissioner, but only if the offering constitutes or would constitute a violation of s. 551.31 and notice thereof has been received by the issuer, or constitutes or would constitute a violation of s. 551.41.

an isolated nonissuer transaction.<sup>175</sup> Under section 551.23(10), registration is not required if an issuer has its principal office in Wisconsin and the aggregate number of persons, directly or indirectly, holding all of the issuer's securities does not exceed fifteen.<sup>176</sup> Section 551.23(11) provides an exemption from registration for transactions pursuant to offers directed to not more than ten persons during a period of twelve consecutive months.<sup>177</sup> Section 551.23(19) of the Wisconsin Statutes provides an exemption if the sale of securities was made in reliance on Rules 505 or 506 of Regulation D under the Securities Act.<sup>178</sup>

Sellers of stock and issuers relying on these transactional exemptions may pay commissions to their broker-dealers or agents provided that appropriate broker-dealer or agents' licenses are obtained, or an exemption from licensing is available. If any commission is paid to an unlicensed person or entity without an applicable licensing exemption, the transactional exemption is lost and the issuer or seller of stock has violated section 551.21(1).<sup>179</sup> Consequently, the issuer or seller of stock may be held jointly and severally liable for rescission with the unlicensed broker-dealer or agent.<sup>180</sup>

Lastly, it should be recognized that "[t]he rights and remedies under [Chapter 551] are in addition to any other rights or remedies that may exist at law or in equity."<sup>181</sup> Thus, a plaintiff can use any combination of statutory or nonstatutory remedies, which includes liability under the common law principles of agency. Specifically, a party may seek to recover under the theory of *respondeat superior*.<sup>182</sup>

175. See *supra* note 171.

176. See *supra* note 172.

177. See *supra* note 173. Note that, sections 551.23(10) and 551.24(14) are subject to additional restrictions contained in WIS. ADMIN. CODE § SEC 2.02(5) (1987).

178. See *supra* note 173.

179. Section 551.21(1) of the Wisconsin Statutes states that "[i]t is unlawful for any person to offer or sell any security in this state unless it is registered under this chapter or the security or transaction is exempted under s. 551.22, 551.23 or 551.235." WIS. STAT. § 551.21(1) (1986-87).

180. See WIS. STAT. § 551.59(4) (1986-87).

181. See *id.* WIS. STAT. § 551.59(9).

182. See *supra* note 154.

### 3. Criminal Liability

Section 551.58(1) of the Wisconsin Statutes states that “[a]ny person who *wilfully violates* any provision of this chapter . . . or any rule under this chapter, or any order of which the person has notice . . . may be fined not more than \$5,000 or imprisoned not more than 5 years or both . . . .”<sup>183</sup> The statute of limitations for securities crimes is controlled by section 939.74 of the Wisconsin Statutes.<sup>184</sup> Therefore, the six-year period to commence an action is tolled upon the issuance of a summons or warrant.<sup>185</sup> Consequently, a court may impose criminal sanctions for all of the violations previously discussed with respect to civil liabilities. These violations include: (1) section 551.21(1), offering un-registered nonexempt securities; (2) section 551.31(1), unlicensed broker-dealer or agent; (3) section 551.31(2), broker-dealer or issuer employing unlicensed agent; (4) section 551.31(2), agent representing more than one broker-dealer or issuer at any one time; and (5) section 551.31(6), licensed broker-dealer or agent transacting business in violation of Chapter 551.

The meaning of the word “wilful” under section 551.58 has been interpreted in two Wisconsin court decisions. In *Van Duyse v. Israel*,<sup>186</sup> Judge Reynolds of the Eastern District Federal Court stated that “[i]t is the nature of the act which is dispositive, *not the state of mind* of the actor.”<sup>187</sup> In this sense, the statute imposes a form of strict liability. Once the seller has “wilfully engaged in conduct which operates or would operate as a fraud or deceit . . . he will not be heard to argue that he did not intend the consequences of his acts.”<sup>188</sup> As discussed above, however, the drafters of the Wisconsin Uniform Securities Act chose not to include specific intent as an element of the crime of fraud in the sale of securities. The drafters instead elected to prohibit wilful violations of the act,

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183. See WIS. STAT. § 551.58(1) (1986-87).

184. See 1981 Wis. Laws § 44.

185. Under prior law, the statute of limitations was tolled only on the filing of an indictment or information.

186. 486 F. Supp. 1382 (E.D. Wis. 1980).

187. *Id.* at 1387 (emphasis added).

188. *Id.*



a standard which does not require a showing of evil motive or knowledge that the law is being violated.<sup>189</sup>

In *State v. Temby*,<sup>190</sup> the Wisconsin Court of Appeals held that intent to defraud was not an element of a criminal offense violation of the Wisconsin Securities Act. Accordingly, the element of intent to defraud was not required to be included in jury instructions.<sup>191</sup> This discussion of the court of appeals is consistent with the district court's holding in *Van Duyse*.

#### 4. Other Forms of Relief

Section 551.57 of the Wisconsin Statutes permits the Commissioner of Securities to seek injunctive relief for past or future violations of chapter 551 or any rules issued under the chapter. Upon a proper showing, a court may grant the following: (1) temporary or permanent injunction; (2) appointment of a receiver for the defendant; or (3) a rescission of any sales or purchases of securities. Furthermore, the language in the statute suggests that injunctive relief could be sought against an issuer, broker-dealer, or agent.<sup>192</sup>

Moreover, pursuant to section 551.34(1), licenses of broker-dealers and agents may be denied, suspended or revoked by the Commissioner for any of the following reasons: (1) materially incomplete, false, or misleading applications; (2) wilful violations of the Wisconsin Securities Act or federal securities law; (3) past convictions of any felony or misdemeanor involving a security business; (4) pending injunctions; (5) licensing denials or suspensions; or (6) engaging in dishonest or unethical practices in the security business.<sup>193</sup>

### VII. PLANNING OPTIONS FOR SELLERS AND BUSINESS BROKERS IN THE SALE OF A CONTROLLING INTEREST IN A BUSINESS

Because of the potential liability for sellers of stock which represents a controlling interest in a business, practicing attorneys should consider the following courses of action to ad-

189. *Id.*

190. 108 Wis. 2d 521, 322 N.W.2d 522 (Ct. App. 1982).

191. *Id.* at 530-31, 322 N.W.2d at 527.

192. *See* WIS. STAT. § 551.57 (1986-87).

193. *See* WIS. STAT. § 551.34(1) (1986-87).

dress the broker-dealer or agent licensing question when structuring a business sale or representing business brokers. First, a business broker should attempt to be characterized as a "finder"<sup>194</sup> by minimizing the scope of activities in connection with the sale of a business. This may be accomplished by merely introducing the parties and not engaging in substantive business negotiations on behalf of the parties. Alternatively, if the business broker effects a controlling interest stock sale which, but for the payment of commission, would have been eligible for a stock transactional exemption pursuant to sections 551.23(10), (11) or (19), or would have been otherwise exempt under section 551.23(1), then a request should be made upon the Wisconsin Commissioner of Securities for an order finding that registration of the stock sale and the business broker is not necessary or appropriate for the protection of investors.<sup>195</sup> If the business broker has passed the required NASD exams, he may be licensed in Wisconsin as an agent of the issuer under section 551.31(2) and receive commissions without jeopardizing the applicable transactional exemption. Under the last two alternatives, the securities transaction should be exclusively intrastate; otherwise, federal broker-dealer licensing may be required allowing a purchaser to seek civil remedies against the broker and seller under federal law.<sup>196</sup>

Additionally, a no-action request to the SEC as to whether the business broker would be deemed a broker-dealer under the factual circumstances could be appropriate if there is sufficient time to await a response. Although this approach provides some level of comfort, the SEC's position will not be binding upon purchasers of stock in the event the business fails and the purchaser seeks private civil remedies.<sup>197</sup> Another means to foreclose a purchaser's use of the civil liability provisions against a seller, broker or agent in an intrastate

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194. See *supra* notes 94-101 and accompanying text.

195. See WIS. STAT. § 551.23(18) (1986-87).

196. Thereupon, the business broker would arguably be excluded from both the definition of broker-dealer and agent under section 551.02(2)(b) because the sale of stock would be exempt under section 551.23. See also notes 63-68 and accompanying text.

197. See generally Lemke, *The SEC No-Action Letter Process*, 42 BUS. LAW. 1019 (1987).

business sale is to close the transaction in escrow, pending the expiration of a thirty-day written rescission offer which should be granted to the purchaser.<sup>198</sup> This rescission offer should state the manner in which liability may have arisen under Wisconsin law. Above all, an active business broker should consider securing both state and federal registrations for broker-dealer status, including membership in the NASD.<sup>199</sup> The registration is a relatively inexpensive proposition when balanced with the rescission liability exposure under state and federal law.

### VIII. CONCLUSION

The legislative history of the Exchange Act and state blue sky laws indicate an intent to regulate the competence and character of those effecting securities transactions. However, the characterization of those who engage in controlling interest business sales as securities brokers creates rather untoward results, in that, a purchaser of a business who is able to pursue a claim against a business broker for failure to register will also benefit by the strict liability imposed upon the seller or issuer of the business. Consequently, the purchaser of the business has effectively been granted a "put" in the stock of the company during the civil statute of limitations period. This potential liability is an unwarranted expansion of the Exchange Act and state blue sky laws because it grants a remedy to a purchaser which is substantially disproportionate to the

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198. See WIS. STAT. § 551.59(6) (1986-87). For a discussion of the rescission process and other methods of curing securities violations see Bromberg, *Curing Securities Violations: Rescission Offers and Other Techniques*, 1 J. CORP. LAW. 1 (1975).

199. If an applicant satisfies minimum qualifications mandated by the rules under the 1934 Act and the respective state blue sky laws, and he is not disqualified by prior activities, an applicant shall be granted a security broker-dealer license. Mechanically, the applicant initiates the process by filing a Form BD together with accompanying exhibits with the SEC. Special forms are required for specialized areas of practice, including municipal securities. Once an application is accepted for filing, the SEC, within 45 days, will grant registration or institute proceedings to determine whether registration should be denied. A broker-dealer must not commence doing business until its registration has been granted and its officers, directors, and other employees have satisfied certain qualifications requirements.

In addition to the federal and state registration requirements, a broker-dealer is required to become a member of the appropriate self-regulating organization, such as the National Association of Securities (NASD). Broker-dealers that affiliate with the NASD are subject to NASD reporting and examination requirements.

harm, and it may be directed at an innocent party, the seller of stock. To the extent a seller of a business misrepresents or fails to disclose material information about the business and sale, the purchaser already has adequate remedies under the Exchange Act and state anti-fraud prohibitions. Nonetheless, until these issues are dealt with by the courts or new legislation, an attorney should take whatever steps are necessary to insure that the uncertainties are eliminated in the scope of the broker's activities do not give rise to licensing requirements.