

Licensed to Deal

Is your business broker/intermediary/M&A advisor properly licensed and registered to represent you in the sale of your company?

Robert St. Germain
Corporate Finance Associates

You worked long and hard to grow your company and now it is time to exit and reap your well deserved rewards. In your case, you decided to sell to a third party because you learned that is typically how business owners maximize their selling price. To that end, you elected to engage the services of a business broker or M&A advisor. You heard that they can help you to more effectively and efficiently recast your financials, create a descriptive memorandum, market your company, screen inquirers, facilitate due diligence, negotiate deal terms, arrange for financing, and otherwise professionally manage the complex, comprehensive, and confidential process of selling a company. All those are burdens you would prefer to leave to someone who specializes in such a process so you can continue focusing on your specialty of operating and growing the value of your business.

You found such an advisor and, with everything seemingly in order, you next signed her standard engagement agreement. Included therein, as is typical in such agreements, was the requirement to pay a fee to the advisor contingent upon the successful sale of your company. Now you are looking forward to accepting a great offer that will allow you to move to sunnier climes and pursue full-time all your other

life's passions. What is not to like about that scenario?

For one thing, do you know if your advisor has her legally required securities licenses and appropriate state registrations? If not, you and she may have just violated both federal and state securities laws, which generally require that anyone who "effects the transaction of securities" be a

Registered Representative working in the context of a Registered Broker-Dealer and be regulated by an organization such as the Financial Industry Regulatory Authority (FINRA), formerly known as NASD. "But", you ask, "what do securities have to do with the sale of my privately held company?" Well, in fact, securities are a component of most private business sale/purchase transactions.

You should note that there are two primary ways to sell your company. It can be sold via either a transfer of stock or a transfer of assets with the choice being the result of negotiations between your side and that of the buyer. In the case of a stock sale, securities in your company will be offered for sale and, at close, will be purchased by the buyer. Not surprisingly that transfer of stock is considered a securities transaction as defined by the Securities Act of 1933.

In the case of an asset sale, the assets of your company will be offered for sale and, at close, will be purchased by the buyer. If the asset sale is for all cash at close that is the one case that would not be considered a securities transaction. However, most asset sales include partial payment of the purchase price over a negotiated period of time via a promissory note, also called a "seller's note", and/or as certain performance metrics are achieved as defined in an earn-out agreement. Like stock, such notes and agreements are also



deemed to be securities by our securities laws.

So it is highly likely that the advisor you hire will be one who “effects the transaction of securities” of one type or another. And at the beginning of an engagement there is no way to predict the final form of the transaction.

Now you might ask, “What is the big deal in not using a properly licensed and registered broker/advisor and how would that affect me anyway?” First, as implied above, business transfers with a securities component in their deal structure that are facilitated by non-licensed/non-registered intermediaries are illegal. In fact, it is also illegal for such an intermediary during the course of her engagement to discuss securities with her client or to even discuss any form of a business transfer that includes a securities component in its deal structure. Second, the remedy available

under the law to cure illegal securities transactions is onerous.

That remedy? The law allows up to five years for an aggrieved party to an illegal securities transaction to exercise their right of rescission. Thereby, the transaction would be reversed or annulled with the company returned to the seller and any consideration paid returned to the buyer. Now think of the difficulties in unwinding such a deal: What is the condition and form of the company compared to when it was “sold” up to five years ago? Where now, after being paid out partly in fees and taxes and/or into trusts, are the proceeds you received from the buyer over the last five years? Etc., Etc. And you thought you had permanently moved on to the next stage of your life!

Then, as one might predict, all parties to the transaction, including you, will likely find themselves the subject of at least civil and, yes perhaps, even criminal lawsuits.

Imagine the recriminations at that point: Who recommended the hiring of that non-licensed/non-registered advisor? Who hired that advisor? Who failed to validate the credentials of that advisor? Who failed to craft language into the deal documents protecting against non-licensed/non-registered advisors? Who failed to properly review those deal documents? Who advised signing the deal documents? Who can I sue for my losses?

And that non-licensed/non-registered advisor that got you into this mess in the first place? She too would be personally liable both civilly, as well as, criminally for her role in the transaction.

Given the potential liabilities associated with an illegal securities transaction, the obvious question arises: “Why would any business broker or M&A advisor practice

without the required securities licenses and registrations?” The answer is simple. It is extremely time consuming and costly to establish and maintain a Registered Broker-Dealer and to become and maintain oneself as a Registered Representative. In addition, once registered, both the B-D and its affiliated Representatives then operate in a highly regulated environment where the failure to comply with any and all applicable regulations exposes them to severe potential penalties. Thus, non-licensed/non-registered brokers/advisors save themselves large overhead expenses and avoid scrutiny by our securities regulators while their clients are left exposed for years to the risk of a costly post-close deal rescission.

You deserve the sale of your business to be a successful, one-time event. You do not want to be party to an illegal securities transaction and risk having the sale revisited and reversed years later. Therefore, you would be wise to only engage the services of a business broker or M&A advisor who is also a Registered Representative (i.e. is sponsored by a Registered B-D); has their required securities licenses (i.e. Series 79 plus the Series 63 that is separately required for interstate transactions); and, further, is registered in the state where their practice is located, the state where the seller is located, if different, and the state where the buyer is located, if different again. Proof of licensures and registrations is available at www.finra.org and at your state’s division of securities. Seek legal counsel first to insure that you are selecting your broker/advisor properly.

About Corporate Finance Associates: CFA, founded in 1956, is one the oldest and most prominent independent private investment banks in North America. It serves the merger, acquisition, divestiture,

recapitalization, financing, valuation, and strategic/exit planning requirements of middle-market sized companies in all industries. It has recorded thousands of successful M&A transactions since inception and is international in scope with offices worldwide. It also has its own Registered Broker-Dealer affiliate, Corporate Finance Securities Inc., through which all securities related transactions are conducted. Learn more about CFA at www.cfaw.com.

About the Author: Mr. St. Germain is a Managing Shareholder with CFA operating out of their Columbus, OH office. His practice is focused on the manufacturing, distribution and B2B service sectors. He is a Certified Business Intermediary (CBI); is a Registered Representative with his Series 24, Series 7, Series 79, and Series 63 securities licenses; and has over 15 years of M&A experience. He earned his Bachelor of Science degree in General Engineering from the U.S. Military Academy at West Point and his MBA degree from Harvard University. He can be reached at 614-476-2291(O), 614-476-2324 (F), 614-325-8486(C), or rstgermain@cfaw.com.

Disclaimer: Mr. St. Germain is not an attorney and this article is neither intended to be nor should it be considered legal advice. If you have any questions, please consult an attorney who specializes in securities law.

Corporate Finance Associates

24461 Ridge Route Drive, Suite A200
Laguna Hills, CA 92653

T/ 949.305.6710
E/ info@cfaw.com

*Robert St. Germain is a Principal in the
Columbus office of Corporate Finance
Associates*

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