LOCKE LORD® QUICKStudy
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Stock Offerings and Securities Laws

Broker-Dealer Registration

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An emerging business seeking to raise capital by selling stock or other securities often does so without the assistance of an investment banker, relying instead on its own officers, directors and employees to conduct the offering. The "self-distribution" of securities by the issuer and its personnel may be undertaken because an investment banker cannot be attracted or because the issuer desires to avoid paying selling commissions. Whatever the reason for self-distribution, the process raises broker-dealer registration issues.

Broker-dealers must register with the SEC unless they are engaged solely in intrastate business or in the business of trading exempted securities. State securities laws also generally require the registration of broker-dealers.

The failure to register as a broker-dealer if required can result in government enforcement action and monetary penalties. In addition, there is a significant risk that the offering could be subject to rescission by investors whose purchase of the securities was induced by an unregistered broker-dealer.

Federal Law

"Broker" is defined in the federal Securities Exchange Act to generally mean any person engaged in the business of effecting transactions in securities for the account of others. "Dealer" is defined to generally mean any person engaged in the business of buying and selling securities for such person's own account, through a broker or otherwise.

With self-distribution, the issuer and its personnel are not likely to fall within the definition of dealer because typically they are not both buying and selling the security. While the issuer would not fall within the definition of broker because it is not effecting transactions for the account of others, the issuer's personnel are doing so (*i.e.*, they are effecting transactions for the account of the issuer) and might meet the broker definition, subjecting them to broker-dealer registration requirements. The principal question for the issuer's personnel is whether they are "engaged in the business" of effecting transactions in securities for the account of others.

To avoid uncertainty about whether someone is "engaged in the business" of effecting transactions in securities for the account of others, Exchange Act Rule 3a4–1 was adopted by the SEC as a nonexclusive safe harbor from the definition of broker for personnel of an issuer who assist the issuer

in connection with the offer and sale of its securities. Generally, under the rule, an "associated person of an issuer" (a term that includes, among others, any person who is a partner, officer, director, or employee of the issuer) will not be deemed to be a broker by reason of his or her participation in the sale of securities of the issuer if the person:

- Is not subject to a statutory disqualification under Exchange Act §3(a)(39);
- Is not compensated for participation in the sale by the payment of commissions or other remuneration based on transactions in securities; and
- Is not at the time of participation an associated person of a broker or dealer.

In addition to the requirements enumerated above, to take advantage of the rule the associated person must meet one of the following conditions:

- The associated person (1) primarily performs substantial duties for the issuer other than in connection with transactions in securities; (2) was not a broker or a dealer or an associated person of a broker or dealer within the preceding 12 months; and (3) does not participate in selling securities for any issuer more than once every 12 months, with certain exceptions; or
- The associated person does no more than (1) prepare approved written communications and deliver such communications without oral solicitation of potential purchasers; (2) respond to inquiries initiated by potential purchasers so long as the response is limited to information contained in the registration statement or other offering document; and (3) perform ministerial and clerical work related to the transaction; or
- The associated person limits participation to transactions enumerated in Rule 3a4–1(a)(4)(i), most of which would not generally be applicable to an offering by an emerging business seeking to raise capital but which include sales of securities that are (1) made to a registered broker or dealer, a registered investment company, an insurance company, a bank or savings and loan association, or certain trust companies and trusts; or (2) made in accordance with a bonus, profit sharing, pension, retirement, thrift, savings, incentive, stock purchase, stock ownership, stock appreciation, stock option, dividend reinvestment, or similar plan for employees of the issuer or one of its subsidiaries.

California Law

Under California law, the term "broker-dealer" does not include an associated person of an issuer who is deemed not to be a broker pursuant to Exchange Act Rule 3a4–1, with certain specified exceptions.

For more information on the matters discussed in this *Locke Lord QuickStudy,* please contact the author:

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