

Real Estate Licensing for Merger and Acquisition Practitioners?

By June Lin

Introduction

Imagine an investment banking firm agrees to assist a company in finding a buyer to purchase the company's stock and is successful in finding a buyer. After the sale of the company's stock, the company refuses to pay the investment banking firm's commission, claiming that the firm, although a licensed securities broker, is not entitled to compensation because it does not possess a real estate broker's license. Surely the company would fail in such a claim? Not necessarily - if the deal is taking place in California.

Or imagine an individual involved in negotiating an asset purchase transaction on behalf of a company that purchases a small portion of another company's assets, consisting of certain customer contracts, supporting equipment, and a pledge of nonsolicitation from the seller. The individual is contractually entitled to commissions of \$20 million from the buyer for his role in arranging the acquisition of the business assets. The buyer refuses to pay, claiming the individual is not licensed as a real estate broker. The buyer wins his argument in court and the individual loses \$20 million of commissions. True story? In California it is.

Regulation of Securities Brokers by the California Department of Real Estate

Some business brokers believe that selling stock falls solely under the securities regulations. Not so in California. Turf wars between securities and real estate brokers were brought to a head in *All Points Traders, Inc. v. Barrington Associates*.¹ In this 1989 case, an investment banking firm (Barrington) agreed to assist a company (All Points) in finding a buyer to purchase its stock. After the sale of All Points' stock, Barrington initiated binding arbitration

¹ 211 Cal.App.3d 723, 259 Cal.Rptr. 780 (1989).

pursuant to the parties' written agreement, seeking payment of a commission. All Points argued in the arbitration that, because Barrington did not possess a real estate broker's license, it was not entitled to any compensation. The arbitrator found in favor of Barrington and awarded it a commission. The superior court confirmed the award. The Court of Appeal reversed, concluding that Barrington needed a real estate broker's license to assist All Points in the sale of its stock. Absent the license, the parties' commission agreement was illegal and unenforceable under the California Real Estate Law, and the arbitration award could not be based on such an agreement.

In this case, the California Court of Appeal held that an investment banking firm which specializes in mergers and acquisitions must possess a real estate broker's license when negotiating the sale of a business opportunity offered by a corporation seeking to transfer all of its stock or assets to a prospective buyer. The court noted that the fact the transaction might also fall within the scope of California's securities regulations was irrelevant because regulation under one statute or scheme does not preclude regulation pursuant to other statutory provisions...the statutory scheme provides no indication that business opportunity regulation and securities regulation in general are mutually exclusive or dismembered from one another.

Almost immediately after, and in reaction to, the *All Points Traders* case, the California legislature amended the Business and Professions Code by adding Section 10008.5 which went into effect as an emergency measure September 30, 1989. That Section says that the Real Estate licensing requirement does not apply to the sale, lease or exchange of a business opportunity transaction that is brokered by a licensed securities broker, unless "the substance of the transaction is to transfer, sell, lease, or exchange an interest in real property for the purpose of evading this part." So, unless the real estate component of a business opportunity sale

transaction represents the “substance of the transaction” (which one commentator has described as the “overwhelming majority of the consideration involved”), the securities broker license would be sufficient, and the commission arrangement would be entirely enforceable. For example, if the sale of business opportunity transaction only involved a piece of real estate held by a limited liability company or corporation, and was structured as a sale of membership interests or stock, the securities broker license would likely not be sufficient, as this would seem to fit the exception. No cases have been decided under Section 10008.5 since its adoption in 1989, so the question of how dominant the real estate component of the transaction must be remains an open issue. For instance, if a business consists of a machine shop plus the building in which the business is conducted, and the real estate value is therefore 75 to 80% of the total business value, we cannot predict whether a court would rule that this transaction is one that can be completed by a securities broker who does not also have a real estate license.

Regulation of Asset Deals by the California Department of Real Estate

The 2007 case *Vincent Salazar v. Interland, Inc.*² makes clear the dangers of arranging asset acquisitions without being aware of the California licensing requirements. In this case, Salazar, who held neither a securities broker’s license nor a real estate broker’s license, learned that AT&T Corporation wanted to sell its small business web hosting division. He contacted Interland and arranged for a meeting between AT&T and Interland. Interland ended up buying AT&T’s small business web hosting division. Interland had previously agreed to pay Salazar a commission, based upon the assets transferred and the number of customers acquired. Salazar sued Interland when he did not receive his commission for \$20 million. The court ruled that Salazar was required to hold a real estate broker’s license under the Business and Professions Code for any sale of a “business opportunity”. The court rejected Salazar’s argument that he was

² 152 Cal. App. 4th 1031, 62 Cal. Rptr. 3d 24 (2007).

entitled to receive the commission because he did not sell the entire business but sold just portions of business assets, customer contracts and good will. Salazar was therefore denied the \$20 million commission, even though he was instrumental in procuring the transaction. The court even refused to grant Salazar compensation for his time and efforts in rendering valuable services to Interland on a quantum meruit theory.

Conclusion

In California, arranging the sale of a “business opportunity” requires a real estate broker’s license, unless the transaction falls within the exception for licensed securities brokers. A licensed securities broker or dealer in California is not required to have a real estate license to effect business sale transactions, whether for stock or assets, unless the transaction is really a disguised sale of real estate. A licensed securities broker may therefore escape regulation under the Real Estate Law by showing that its activities are not those of a real estate broker because the interest bought and sold is not predominantly an interest in real estate. An individual that is not licensed as either a securities broker or a real estate broker and arranges a sale of a business opportunity is, unfortunately, out of luck.

This article is intended to provide a general summary and should not be construed as a legal opinion nor a complete legal analysis of the subject matter. June Lin is an attorney at Niesar & Vestal LLP in San Francisco, a law firm specializing in business law and corporate finance.