

NEWS ALERT

SECURITIES GROUP



MA SJC Weighs In On Broker-Dealer Registration Requirements

By Mark J. Tarallo | March 26, 2020

The Massachusetts Supreme Judicial Court (SJC) recently considered a case discussing whether or not actions by a financial advisor rose to a level that triggered broker-dealer registration requirements. As part of the case, the SJC ruled on the definition of a security and its application. Lightship Global Ventures LLC (the plaintiff) hired NTV Management, Inc. to provide “consulting and advisory services” in connection with Lightship’s efforts to acquire “the business and assets” of the website Salary.com from International Business Machines Corporation (IBM). NTV’s duties under the agreement included assisting Lightship in structuring the transaction and facilitating and participating in meetings with potential sources of capital. A fee of \$330,000 was payable to NTV on completion of the acquisition transaction.

The arrangement did not go well, and Lightship ultimately acquired Salary.com by using funds raised from parties unrelated to NTV. NTV, believing itself entitled to the advisory fee, filed suit against Lightship. A Superior Court jury found Lightship liable for breach of contract and breach of the implied covenant of good faith and fair dealing and awarded NTV damages of \$330,000. The jury also found that Lightship and its principal knowingly or willfully had engaged in unfair or deceptive practices in violation of G. L. c. 93A, and awarded NTV treble damages.

The defendants then moved to “invalidate” the verdict, on the ground that NTV had not registered as a broker-dealer, in violation of the Massachusetts Uniform Securities Act (Massachusetts act), G. L. c. 110A, § 201 (a), and the Federal Securities Exchange Act of 1934 (Federal act), 15 U.S.C. § 78o(a). Under each act, such violations would render the contract between the parties unenforceable. See 15 U.S.C. § 78cc(b); G. L. c. 110A, § 410 (f). The trial judge concluded that NTV had been required to register as a broker-dealer, and that its failure to do so rendered the contract invalid and unenforceable. The trial judge further concluded that, absent a valid contract, NTV could not sustain its claim under G. L. c. 93A, and therefore, he vacated the jury award in its entirety. NTV then appealed this ruling.

The SJC found that the contract between the parties did not require NTV to register as a broker-dealer. The SJC ruled that while the contract called for NTV to “source capital and structure financing transactions from agreed-upon target investors and/or lenders,” and that “NTV expect[ed] to introduce and facilitate investment from third party sources collectively able to finance all levels of the transactions (i.e., both equity and debt),” Lightship ultimately had the right to determine “whether or not to enter into a definitive arrangement,” and agreed to “act in good faith with NTV to determine the capital structure and sources of capital” in the way most beneficial to Lightship. Since the agreement did not explicitly call for a particular transaction structure or instrument to be sold, the court ruled that the agreement did not require a transaction in securities, and therefore NTV was not required to register as a broker-dealer.

The court's analysis included a detailed review of both the statutory definition of securities and the "four factors" test expressed in *Reves v. Ernst & Young*, 494 U.S. 56, 64-65 (1990), but did not change the settled case law as to the definition of a security. The court's opinion also did not address, at all, whether or not NTV was a "finder", a term that is not defined in the securities laws and is frequently misinterpreted, usually to the detriment of everyone involved in a transaction. Businesses that are contemplating an arrangement with a third party to raise capital must always consider whether or not that third party needs to be registered as a broker-dealer, and in many (if not almost all) cases the answer is "yes". A failure to register not only can call the enforceability of such an arrangement into question, but also may give rescission rights to the ultimate buyer of securities.

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