33rd PIABA Annual Meeting

NUTS AND BOLTS OF BROKER-DEALER SUCCESSOR LIABILITY

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NUTS AND BOLTS OF BROKER-DEALER SUCCESSOR LIABILITY

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Many PIABA members have faced this situation before. A potential client calls you and presents a possible case regarding an investment that has lost significant value. After doing some research, you find that the brokerage firm that sold the investment to your potential client has gone out of business since the transaction took place. However, you also find that the brokerage firm had "sold" its assets to another firm or was somehow merged into another broker-dealer. How do you go about holding the new broker-dealer responsible, or successor, for conduct that was done at the prior firm, or predecessor? Our session aims to highlight the laws and circumstances that you should consider under this scenario.

Whether to hold the new broker-dealer liable for the acts of the prior broker-dealer is governed by "corporate successor liability". Generally, "where one company sells or otherwise transfers all its assets to another company the latter is not liable for the debts and liabilities of the transferor, including those arising out of the latter's tortious conduct". *Ramirez v. Amsted Industries, Inc.*, 431 A.2d 811 (N.J. 1981).

However, under most states' laws, a corporation that merges with another corporation or purchases the assets of another corporation can be liable for injuries resulting from conduct of a predecessor corporation if it is shown that (1) the buyer expressly or impliedly agrees to assume such liability; (2) the transaction amounts to a de facto consolidation or merger; (3) the buyer corporation is merely a continuation of the seller corporation; or (4) the transaction is entered

into fraudulently for the purpose of escaping liability. *Flaugher v. Cone Automatic Mach. Co.,* 507 N.E.2d 331, 334 (Ohio 1987); *see also Ray v. Alad Corp.*, 560 P.2d 3, 28 (Cal. 1977); *Ramirez v. Amsted Industries, Inc.*, 431 A.2d 811 (N.J. 1981); *Laboratory Corp. of America v. Professional Recovery Network*, 813 So.2d 266, 269 (Fla. App. 2002); *First Support Services, Inc. v. Trevino,* 655 S.E.2d 627, 630 (Ga. App. 2007).

Applying the law to the particular facts and circumstances of your case, you will need to do additional research to determine whether your case meets one of the four exceptions listed above. This session intends on helping you make that determination.

A. *Assumption of Liabilities*

This exception is the most straight-forward: did the successor agree to assume the liabilities of the predecessor as part of the transaction. When trying to figure out whether the successor agreed to assume the liabilities of the predecessor, you need to look at the contract or transaction documents that governed the purchase or merger. While successors are usually careful about how the purchase contract is worded and specifically excludes purchasing the liabilities of the predecessor, in some instances the successor purchases everything pursuant to the contract. But where can you get this document?

You can always ask for this in discovery, but many practitioners would like to find this information ahead of time. If the firm that you're contemplating suing is a publicly-traded company, you should be able to find these documents on SEC Edgar, or you may be able to find this buried on the successor's website.

However, if you cannot find these documents or get them directly from the successor, you may consider reaching out to FINRA and FINRA Membership Application Program (MAP).

B. *De Facto Merger*

The more likely way to find corporate successor liability is to show that despite the terms of the purchase agreement between predecessor and successor, the transaction amounts to a *de facto* merger. A *de facto* merger is a transaction that results in the dissolution of the predecessor corporation and is in the nature of an absorption of the previous business into the successor. *Welco Industries, Inc. v. Applied Companies*, 617 N.E.2d 1129, 1134 (Ohio 1993). A *de facto* merger is a merger in fact without an official declaration of such. The hallmarks of a *de facto* merger include (1) the continuation of the previous business activity and corporate personnel, (2) a continuity of shareholders resulting from a sale of assets in exchange for stock, (3) the immediate or rapid dissolution of the predecessor corporation, and (4) the assumption by the purchasing corporation of liabilities and obligations ordinarily necessary to continue the predecessor's business operations. *Pottschmidt v. Klosterman*, 865 N.E.2d 111, 119 (Ohio App. 2006); *see also Turner v. Bituminous Casualty Co*., 244 N.W.2d 873 (Mich. 1976); and *Cargill, Inc. v. Beaver Coal & Oil Co*., 424 Mass. 356, 360 (1997). Where the successor corporation shares significant features with its predecessor, no basis exists for treating a purchase of assets differently from a *de facto* merger. *Klosterman*, 865 N.E.2d at 119.

In *Klosterman*, the liability of a corporation that bought the assets of another was at issue. The *Klosterman* Court considered several factual matters: 1) the new corporation took possession of the original corporation's office equipment, supplies, and accounts receivable; 2) the new corporation had substantially the same patients and operated in the same building as the original corporation; 3) the new corporation assumed the monthly lease and equipment rental expenses that the original corporation previously paid; 4) the original corporation's employees were

employed by the new corporation and were compensated by the new corporation for services rendered to the original corporation; 5) the original corporation retained no assets; and 6) the original corporation effectively stopped operating after the asset purchase. *Klosterman*, 865 N.E.2d at 119. Based on these facts, the Court concluded that there was credible evidence to determine that the new corporation was liable for the tortious conduct of the original corporation.

In the broker-dealer context, there are some factors you should consider:

a) Did most or all of the advisors/brokers transfer (such as via a "mass transfer") from the predecessor to the successor?

b) Did most or all of the predecessors' customers transfer over to the successor?

c) Did the successor simply buy the "customer list" of the predecessor?

d) Does the successor work in the same office space or building as the predecessor?

e) Did the successor take on any leases of the predecessor?

f) How many employees did the predecessor have?

g) How many of the predecessor employees worked for the successor after the transaction?

h) Did the predecessor withdraw its broker-dealer license? If so, did the brokers or employees of the predecessor begin their affiliation shortly after the BDW?

C. *Continuation of Seller*

When a buyer and seller share significant features such as the same employees, a common name, or the same management, the buyer can be construed to be a mere continuation of the seller. *Klosterman*, 865 N.E.2d at 120. Determining this exception has similar considerations as the "de facto merger" exceptions. However, you can look for other instances

of a "continuation" of the business, such as if the successor issues press releases disclosing that it is continuing on the business of the predecessor. Also, if high level employees or directors of the predecessor have the same or similar roles at the successor, then this could be an example that the merger is merely a "continuation" of the business.

D. *The Transaction Is Fraudulent for the Purpose of Escaping Liability*

Under the last standard to hold a successor liabile for a predecessor's conduct, the plaintiff must show that the transaction was entered into fraudulently for the purpose of escaping liability. While this does not necessarily always apply in the context of broker-dealers, it can be shown.

Under the Uniform Fraudulent Transfer Act ("UFTA"), which has been adopted in 45 states (as well as the District of Columbia and the U.S. Virgin Islands), any transfer made with "actual intent to hinder, delay or defraud" any present or future creditor is a fraudulent transfer that may be set aside or result in liability for the parties to the transfer. Under Section 4(a) of the UFTA, a transfer is fraudulent if the debtor made the transfer with actual intent to hinder, delay, or defraud any creditor. The best way to demonstrate that a fraudulent transfer was done in the corporate successor context is to show that there was no consideration paid for the transfer of assets, or if the consideration was grossly inadequate. See Section 4(a)(2)(i) (stating that "A transfer is fraudulent (whether the creditor's claim arose before or after the transfer was made) if the debtor made the transfer without receiving a reasonably equivalent value in exchange for the transfer, and the debtor was engaged in a business or a transaction for which the remaining assets of the debtor were unreasonably small").

Likewise, under Section 4(a)(2)(ii), a transfer is considered fraudulent if the transfer is made without receiving a reasonably equivalent value in exchange, and debtor believed (or should have believed) that he would incur debts beyond his ability to pay as they became due.

However, mere knowledge that the seller is indebted to another or even knowledge of the existence of a valid and pending cause of action against the seller has been found to be insufficient to show the purchaser's participation in a fraudulent conveyance. Fraud is generally a question of fact, and courts will carefully scrutinize the evidence in deciding whether there is sufficient evidence of a fraudulent transfer before imposing liability.

Claims made under Sections 4(a)(1) of the UFTA must be made within 4 years after the transfer was made or the obligation was incurred or, if later, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant. Claims made under Sections 4(a)(2) or 5(a) of the UFA must be made within 4 years after the transfer was made or the obligation was incurred.

Of course, the UFTA may not be codified uniformly across all states. You need to check with your state's laws to see whether the specific laws conform to, or are different than, the UFTA.

dealer,[11] (3) avoiding any association with a registered broker or dealer for a period of time,[12] and (4) avoiding association with any broker-dealer in a supervisory capacity.[13] The Commission has relied upon a broker's commitment to withdraw in settlement agreements which effected a withdrawal from registration,[14] as well as in settlement agreements effecting withdrawal of application for registration.[15]

§ 2:15 Judicial interventions

Failure of the Commission to strictly adhere to the directives of Rule 15b6-1 [17 C.F.R. § 240.15b6-1] in denying a request for withdrawal has been held not to bar the effectiveness of the Commission's action. In *M.G. Davis & Co. v. Cohen*,[1] the plaintiff broker-dealer sought a judicial declaration that its withdrawal from registration had become effective. Further, the broker-dealer demanded that the Commission be enjoined from maintaining public proceedings against it for violations of the Securities Act of 1933. The basis of the broker's requests was that the Commission had failed to institute its disciplinary proceedings against the broker within the time period allotted pursuant to Rule 15b6-1 [17 C.F.R. § 240.15b6-1]. Today, that period is 60 days, but in 1964, when the events of *M.G. Davis* unfolded, it was 30 days. The broker argued that as a result of the Commission's failure to timely initiate disciplinary proceedings, the broker's request for withdrawal should be automatically effective. To the contrary, the Court of Appeals for the Second Circuit took the position that the Commission's "excess" could not be considered so extreme as to warrant upsetting the Commission's procedures.[2] The court noted that the Commission was "at best" violating only its own Rule.[3] Had the Commission chosen, it could have set a lengthier period of time in which it could initiate proceedings and still bar a withdrawal request. In addition to holding that the Commission need not strictly comply with its own rules regarding withdrawal, the court also held that the

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[11]In re C.D. Pulis & Co., Admin. Proc. File No. 3-5239, Exch. Act Release No. 14,470 (Feb. 14, 1978).

[12]In re Steven A. Kuna, Jr., Admin. Proc. File No. 3-6152, Exch. Act Release No. 19,256 (Nov. 18, 1982).

[13]In re C.D. Pulis & Co., supra.

[14]See, e.g., In re Money Placement Serv., Inc., Admin. Proc. File No. 3-6229, Exch. Act Release No. 19,651 (April 4, 1983), supra.

[15]In re Capital Dev. Assoc., Exch. Act Release No. 11,411 (May 9, 1975).

[Section 2:15]

[1]M. G. Davis & Co. v. Cohen, 369 F.2d 360 (2d Cir. 1966).

[2]Id. at 363.

[3]Id.

broker's relief from such Commission behavior should not come from judicial intervention until administrative remedies and reviews were exhausted.[4]

In another instance in which a broker sought to enjoin the Commission from conducting an administrative proceeding against the broker and also requested a judicial declaration permitting withdrawal from registration, the U.S. District Court for the District of Puerto Rico denied the requests, but indicated that it was not passing upon the conduct of the broker.[5] The court even suggested that the broker might vindicate its position at a Commission hearing, but that such a determination can only be made by the SEC "after a hearing which is expressly provided for in the Exchange Act."[6] Thus, registered brokers cannot avoid the Commission's authority to grant or deny withdrawal from registration by seeking to obtain judicial declarations of withdrawal.

IV. REGISTRATION OF SUCCESSORS AND AMENDMENTS TO REGISTRATION

§ 2:16 Registration methods for successors

The Exchange Act provides for the registration of "successors" to broker-dealers.[1] A successor is an as yet unregistered entity that intends to continue the business of a registered broker-dealer. The purpose of the successor provision in the Act is to enable the successor to continue the predecessor's business without interruption by relying upon the registration of the predecessor for a limited period of time.

There are essentially two alternative methods for registration of a successor broker-dealer. Either method, if properly followed, will permit the successor broker-dealer to legally continue the business of its predecessor broker-dealer without interruption even during the pendency of the successor's registration request.[2]

Under the first approach, the registration of the predecessor is deemed to remain effective as the registration statement of the suc-

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[4]Id.

[5]Fontaine v. Securities and Exchange Commission, 259 F. Supp. 880 (D.P.R. 1966).

[6]Id. at 886.

[Section 2:16]

[1]Section 15(b)(2) of the Exchange Act, 15 U.S.C. § 78o(b)(2).

[2]The Commission has advised that the purpose of its broker-dealer succession rules "is to facilitate a smooth transition period when one broker-dealer succeeds to and continues the business of another registered broker-dealer." Exch. Act Release No. 22,468 (Sept. 26, 1985), Fed. Sec. L. Rep. (CCH) ¶ 83,919, at 87,826.

cessor for a period of 45 days after the date on which the successor files its own application for registration on Form BD, so long as an application on Form BD is filed by the successor within 30 days of succession.[3] Thus, if a second business that is not a registered broker-dealer acquires a registered broker-dealer, the unregistered acquiring business may legally continue the activities of the acquired broker-dealer even though the acquiring company's application for registration is not yet effective.[4] As discussed above,[5] the Commission has 45

[3]Rule 15b1-3(a), 17 C.F.R. § 240.15b1-3(a). Prior to 1993, the grace period, during which the predecessor's registration would remain effective, was 75 days after succession. The Commission amended Rule 15b1-3, effective January 25, 1993 [17 C.F.R. § 240.15b1-3]. Exch. Act Release No. 31,661 (Dec. 28, 1992), 3 Fed. Sec. L. Rep. (CCH) ¶ 25,104A. The Commission explained that the 45-day period is consistent with the broker-dealer registration section of the 1934 Act, which provides the Commission with 45 days in which to grant registration or to institute proceedings to determine if registration should be denied. Id. at n.8, ¶ 18,071-8. The Commission also explained that the 45-day period will not begin to run until a *complete* application is filed by the successor. This approach will prevent the situation in which, because an application was incomplete in minor respects, the 75-day period expired before the successor broker-dealer's registration became effective. Id. The Commission has advised that although it will permit the successor to obtain the presumption of a filing within 30 days when the application is incomplete in minor respects, "[a] successor entity . . . will not be permitted to "lock in" the 30-day window period by submitting an application that is incomplete in major respects, or by otherwise failing to file an application that represents a good faith attempt at compliance with the successor rules." Id. at ¶ 18,071-11.

[4]The staff has permitted the use of the successor provision in a corporate reorganization in which the successor business was a sister business to the original broker-dealer and was wholly owned by the same shareholder who wholly owned the original broker-dealer. French-American Securities Corporation, SEC No-Action Letter (avail. Oct. 17, 1989). In the fact pattern involving the French-American Securities Corporation (FAS) no-action letter, FAS, an Illinois Corporation, had sold its clearing and correspondent business close to a year prior to its no-action request. FAS had also been transferring its proprietary trading accounts to a wholly-owned affiliate. FAS proposed to transfer its assets and liability relating to its OTC market-making and trading activities to a newly formed Delaware corporation, Nash Weise & Company (NWC), which was solely owned and directed by the sole owner and director of FAS. After the transfer, FAS would have no further broker-dealer activities and would withdraw its broker-dealer registration. NWC would continue the broker-dealer business of FAS. The staff indicated that it would not object to the use of the successor status by NWC provided it filed a complete application for registration as a broker-dealer on Form BD within 30 days of the completion of the proposed transaction.

The staff has also permitted the use of the successor provisions found in Rule 15b1-3(a) [17 C.F.R. § 240.15b1-3(a)] when multiple brokerage firms merge into a single successor corporation. LIT America, Inc., SEC No-Action Letter (avail. June 2, 1988). In the no-action letter, several previously owned and newly acquired brokerage firms merged into a single Delaware corporation, LIT America, Inc. (LIT). Following the consolidation, LIT planned to establish internal divisions to reflect the lines of

days within which to grant the application for registration of the acquiring company or to institute proceedings to determine whether registration should be denied.[6] Municipal securities dealers are similarly regulated. The predecessor's registration remains effective for the successor for a period of 75 days after succession as long as an application for registration on Form MSD (for bank municipal securities dealers) or Form BD (for other municipal securities dealers) is filed within 30 days after succession.[7]

Under the alternative approach to registration, a successor broker-dealer that is not registered may file an amendment to Form BD and have it deemed an application for registration if the following two requirements are met: (1) The amendment must be filed within 30 days of the succession and (2) the succession must be based solely upon a change of the predecessor's business form.[8] The form will be deemed an application filed by the predecessor and adopted by the successor, even if it is designated as an amendment. Changes in business form that will trigger the availability of the alternative method are limited to "a change in the predecessor's date or state of incorporation, form of organization or composition of a partnership."[9] Thus, a registered brokerage firm which is organized as a partnership need not file an entirely new Form BD each time it is dissolved and reformed to reflect changes in partnership membership, nor does it need to cease doing business during these business form changes. Rather, the reconstituted firm need only file an amendment to Form BD within 30 days of the succession. This amendment will be deemed an application for registration. As with any application for registration, the Commission then has 45 days within which to either grant registration or to initiate proceedings to determine if registration should be denied. Accordingly, the altered firm may thus continue to do business for as long as a total of 75 days after the business change. During this time, the Commission is required to render judgment upon the registration application of the altered business. The successor's amendment need only include page one of Form BD (the execu-

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business previously conducted by the merged firms. The staff indicated that it would not object if LIT used the successor status provided it filed an application for registration on Form BD within 30 days of completion of the merger. The staff took no position as to whether LIT could retain the predecessor broker-dealer's names and operate them as divisions of LIT.

[5]See supra subd I.

[6]Exchange Act § 15b(1)(A) and (B), 15 U.S.C. § 78o(b)(1)(A) and (B).

[7]Rule 15Ba2-4, 17 C.F.R. § 240.15Ba2-4.

[8]Rule 15b1-3(b), 17 C.F.R. § 240.15b1-3(b).

[9]Id.

tion page), page two (indicating that the applicant is a successor), and those other pages on which any information has changed.

In order to be able to use the alternative approach to registration, in which an amendment to the predecessor's registration is filed, the change in form or organization, prompting the successor registration, must involve the creation of a new legal entity but may not result in the practical change in control of the broker-dealer.[10] The Commission has advised that the presumption of "control" in the instructions to Form BD may provide some guidance as to whether an actual change of control has occurred.[11]

When a brokerage firm separates into two firms, each may be considered a successor. An example is a registered full service firm that wishes to spin off its clearing function and operate that service independently from its introducing function. Each firm would then be a successor to the original, registered firm. The Commission has determined that only one of the successor firms may register by use of an amendment to Form BD pursuant to Rule 15b1-3 [17 C.F.R. § 240.15b1-3].[12] The other firm must file a complete Form BD in order to reflect that there are now two broker-dealers instead of the original one.[13]

In the reverse situation, when two registered broker-dealers merge, the Commission has advised that the successor rules do not apply.[14] Instead, when such registered firms merge, the surviving broker-dealer would file an amendment to its Form BD and the acquired broker-dealer would file to withdraw its registration on Form BDW.[15] The Commission has also explained that the successor rules do not apply when the predecessor intends to continue in the broker-dealer business.[16] Accordingly, when a registered broker-dealer still remains in the brokerage business but transfers some of its operations to a new firm which is unregistered, the new entity must file a complete application for registration and must refrain from conducting a brokerage business until that application is approved by the Commission.

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[10]Exch. Act Release No. 31,661 (Dec. 28, 1992), 3 Fed. Sec. L. Rep. (CCH) ¶ 25,104A at ¶ 18,071-9.

[11]Id.

[12]Exch. Act. Release No. 22,468, (Sept. 26, 1985), Fed. Sec. L. Rep. (CCH) ¶ 83,919, at 87,826.

[13]Id. When multiple brokerage firms merged into a single entity, the staff permitted successor status to be assumed by the surviving firm. LIT America, Inc., SEC No-Action Letter (avail. June 2, 1988). The staff, however, took no position regarding whether the successor firm could retain the predecessor broker-dealer's names.

[14]Exch. Act Release No. 31,661 (Dec. 28, 1992), 3 Fed. Sec. L. Rep. (CCH) ¶ 25,104A.

[15]Id. at ¶ 18,071-8.

[16]Id.

§ 2:17 Criteria for determining a successor

Not all successors of a business are eligible to use the successor application rules. The Commission has advised that the successor rules cannot be utilized to "eliminate a substantial liability."[1] Beyond succeeding to and continuing the business of a predecessor broker-dealer, the successor must assume substantially all of the assets *and the liabilities* of the predecessor broker-dealer.[2] In further explanation of the business nexus requirement between the predecessor and the successor, the Commission has explained that "[a]lthough . . . the successor need not acquire *every* asset and liability of the predecessor, it may not exclude any significant asset or liability."[3] What this means is that an entity that does not assume substantially all of the assets and liabilities of its predecessor "must wait until its own registration

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[Section 2:17]

[1]Exch. Act Release No. 22,468 (Sept. 26, 1985), Fed. Sec. L. Rep. (CCH) ¶ 83,919. See also Exch. Act Release No. 31,661 (Dec. 28, 1992), 3 Fed. Sec. L. Rep. (CCH) ¶ 25,014A.

[2]Exch. Act Release No. 22,468 (Sept. 26, 1985), Fed. Sec. L. Rep. (CCH) ¶ 83,919; Exch. Act Release No. 31,661 (Dec. 28, 1992), 3 Fed. Sec. L. Rep. (CCH) ¶ 25,014A. See also Franklin Financial Services, Inc., SEC No-Action Letter (avail. July 2, 1987), Fed. Sec. L. Rep. (CCH) ¶ 78,529 (the staff permitted the new brokerage firm to use successor status when the old brokerage firm retained only "insubstantial assets not necessary for the ongoing operations of the brokerage business").

It is interesting to note that even when a successor firm did assume all of the liabilities of a predecessor firm, the Commission staff did not support the argument that customers of the predecessor firm qualified as "established customers" of the successor firm for purposes of Rule 15c2-6 of the 1934 Act [17 C.F.R. § 240.15c2-6]. Hayne, Miller & Farni, Inc., SEC No-Action Letter (avail. April 4, 1990). Rule 15c-6 is an antifraud regulation designed to curb certain sales abuses in connection with low priced securities (penny stock). 17 C.F.R. § 240.15c-6. The Rule imposes significant suitability obligations upon broker-dealers who sell penny stock. Paragraph (c)(2) of the Rule, however, provides an exemption from compliance with the Rule when a broker sells to an "established customer." The term "established customer" is defined by the Rule as a customer whose account is carried by the broker and who, in that account, either effected a securities transaction more than one year previously or who had already made three separate purchases of different nonlisted securities in corporations with low net asset value. In the Hayne, Miller & Farni, Inc. letter, it was argued that customers of the predecessor firm should qualify as established customers of the successor firm to the extent that the activity conditions of the exemption had been satisfied by the customer at the predecessor firm. The staff was unwilling to take a no-action position that would have supported this argument. Thus, while the successor firm acquired all of the liabilities of the predecessor firm, it did not necessarily acquire the particular relationship qualities with the customers of the predecessor firm.

[3]Exchange Act Release No. 31,661, 3 Fed. Sec. L. Rep. (CCH) ¶ 25,014A, at 18,071-8 (Dec. 28, 1992) (emphasis in original).

becomes effective before engaging in business as a broker-dealer."[4] Furthermore, the successor rules cannot be used when the predecessor was merely an inactive shell which did not do any business and which is brought to life by the succession.[5]

In summary, the Commission has advised that

> [T]he successor rules . . . are intended to be used only where there is a direct and substantial business nexus between the predecessor and the successor. They are *not* designed to allow registered broker-dealers . . . to sell their registrations, eliminate substantial liabilities, spin off personnel, or to facilitate the transfer of the registration of a "shell" organization that does not conduct any legitimate business."[6]

The failure of a successor to obtain all of the assets of a predecessor, as well as the fact that the predecessor continued as a corporate entity although conducting no business, were factors that the Commission focused on in determining that a successor broker indeed did not succeed to the registration of its predecessor.[7] The Commission staff, however, has not required that a successor obtain all of the exchange membership rights or accounts of a predecessor in order to be deemed a successor.[8] Also, the staff of the Commission has permitted a successor firm to use the successor provisions of Rule 15b1-3 [17 C.F.R. § 240.15b1-3] even when the successor firm did not acquire all of the assets and liabilities of the old firm but, rather, acquired all of the assets and liabilities of the old firm which related to the old firm's broker-dealer operations.[9] In the Alpha Management no-action letter, the staff indicated that it would not object to the successor firm's use of Rule 15b1-3 [17 C.F.R. § 240.15b1-3] in this situation as long as the

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[4]Id.

[5]Exchange Act Release No. 22,468, Fed. Sec. L. Rep. (CCH) ¶ 83,919 (Sept. 26, 1985); Exchange Act. Release No. 31,661, 3 Fed. Sec. L. Rep. (CCH) ¶ 25,014A (Dec. 28, 1992).

[6]Exchange Act Release No. 31,661, 3 Fed. Sec. L. Rep. (CCH) ¶ 25,014A, at 18,071-8 (Dec. 28, 1992) (emphasis in original).

[7]In the Matter of F. W. Horne & Company, Inc., Exchange Act Release No. 5597, 38 S.E.C. 104, (1957). The successor also failed to notify the predecessor that it considered itself a successor.

[8]Charles A. Felt, SEC No-Action Letter, 1980 WL 17685 (Aug. 10, 1980) (partnership succeeds to individual's brokerage business, but individual retains certain accounts); Oscar Gruss & Son, SEC No-Action Letter, 1977 WL 10687 (Dec. 5, 1977) (corporation succeeds to the business of a partnership but only one of two membership seats are transferred).

[9]Alpha Management Inc., SEC No-Action Letter, 1989 WL 246642 (Dec. 21, 1989).

old firm withdrew its broker-dealer registration and the new firm filed a complete application for registration on Form BD.[10]

§ 2:18 Amendments to Form BD

If any of the information contained in an application for registration, or any amendments thereto, becomes inaccurate for any reason, the broker-dealer is required to file an amendment to the application on Form BD.[1] Amendments to Form BD are filed with the Central Registration Depository (CRD) operated by the National Association of Securities Dealers, Inc.[2] This information is then forwarded electronically to the SEC. Information may become inaccurate because of events subsequent to the filing of the initial application. Information may also be inaccurate because of inaccuracies in the original application. In both instances, the remedy is the filing of an amendment on Form BD. An amendment filed pursuant to Rule 15b3-1 [17 C.F.R. § 240.15b3-1] constitutes a report for the purposes of Sections 15(b), 17(a), and 32(a) of the 1934 Act.[3] To amend Form BD, the broker-dealer need not refile the entire form. The amendment, however, must include a completed execution page plus any page containing an amended item with a circle drawn about the amended item.[4]

The Commission considers failure to amend Form BD when information therein becomes inaccurate a violation of Rule 15b3-1 [17 C.F.R. § 240.15b3-1] and Section 15(b). The Commission will impose disciplinary sanctions upon broker-dealers who fail to promptly file amendments to Form BD. Typically, if a broker-dealer is disciplined for not filing an updating amendment, it is only one of a number of violations committed by the sanctioned broker-dealer. Consequently, it is not always possible to determine if the nonfiling of an amendment, in and of itself, would trigger Commission sanctions. The Commission has sanctioned brokers for behavior which included nonfiling

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[10]Id.

[Section 2:18]

[1]Rule 15b3-1(b), 17 C.F.R. § 240.15b3-1(b). For a discussion of what information needs to be contained in Form BD, which information would need to be amended if it becomes inaccurate, see supra § 2:6. Instructions for amending Form BD can be found in Appendix 2.03.

[2]Rule 15b3-1 [17 C.F.R. § 240.15b3-1]. This rule was amended in 1992 to provide for a single filing with the NASD which then shares the information with the SEC. Exchange Act Release No. 31,660, Fed. Sec. L. Rep. ¶ 85,101 (Dec. 29, 1992).

[3]Rule 15b3-1(c), 17 C.F.R. § 240.15b3-1(c).

[4]See Instructions to Form BD in Appendix 2.02. Also, see Instructions for Completing or Amending Form BD in Appendix 2.03.

of amendments for matters ranging from the mundane to the serious. Thus, brokers have been disciplined by the Commission for behavior which included failure to file an amendment notifying the Commission of address changes,[5] changes in officers of a brokerage firm,[6] NASD imposed disciplinary sanctions,[7] changes in control of a brokerage firm,[8] changes in clearing agents used,[9] and imposition of injunctions[10] and disciplinary sanctions.[11]

The Commission has imposed sanctions upon brokers for failing to update registrations after events have rendered the Form BD inaccurate,[12] as well as for failing to amend registrations which, when initially filed, were inaccurate.[13] In the latter instance, the registrant is susceptible to a double sanction, one for the initial informational

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[5]In re Ben Zenoff Co., 44 S.E.C. 719, 722–23 (1971); In re Lloyd D. Sahley & Louis Goldblatt, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 79,562, 83,540–83,544 (Nov. 1, 1973); In re Kanan Sec., Inc., Admin. Proc. File No. 3-6563 (Sept. 25, 1985) (order for public proceedings).

[6]In re Commonwealth Sec. Corp., 43 S.E.C. 833, 836 (1968); In re D.S. Meyers & Co., Admin. Proc. File No. 3-6507, Exchange Act Release No. 22,417 (Sept. 17, 1985).

[7]In re Michael Levinson & Co., Admin. Proc. File No. 3-6587, Exchange Act Release No. 23,295 (Nov. 14, 1985) (order for public proceedings).

[8]In the Matter of Kobbe & Company, Incorporated, Exchange Act Release No. 4940, 35 S.E.C. 318, 1953 WL 44130 (1953).

[9]In re Michael Levinson & Co., Admin. Proc. File No. 3-6587, Exchange Act Release No. 23,295 (Nov. 14, 1985). In re Kanan Sec., Inc., Admin. Proc. File No. 3-6563 (Sept. 25, 1985).

[10]In re Lloyd D. Sahley & Louis Goldblatt, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 79,562, 83,540–83,541 (Nov. 1, 1973).

[11]In re Michael Levinson & Co., Admin. Proc. File No. 3-6587, Exchange Act Release No. 23,295 (Nov. 14, 1985). In re Marshall & Meyer, Inc., Admin. Proc. File No. 3-6525, Exchange Act Release No. 22,555 (Oct. 24, 1985).

[12]In re Shiner, King & Wellesley Fin. Serv., Inc., Admin. Proc. File No. 3-6759, Exchange Act Release No. 23862 (Dec. 3, 1986) (registration revoked of broker-dealer which failed to promptly amend Form BD to reflect felony convictions of its two principal officers and owners); In the Matter of Kobbe & Company, Incorporated, Exchange Act Release No. 4940, 35 S.E.C. 318, 1953 WL 44130 (1953) (failure to report change in control); In re D.S. Meyers & Co., Admin. Pro. File No. 3-6507, Exchange Act Release No. 22,417 (Sept. 17, 1985) (failure to report change in officers).

[13]F.S. Johns & Co., 43 S.E.C. 124, 140 (1966) (failure to amend initial application which did not disclose a controlling person); In the Matter of Kenneth Leo Bauer, Exchange Act Release No. 4006, 26 S.E.C. 770, 1947 WL 24474 (1947) (failure to correct initial inaccuracies); In re Jaron Equities Corp., Sheridan Manhattan Group, Inc. and Dermont Sheridan, Admin. Proc. File No. 3-9285 (Apr. 3, 1997) (registration revoked because broker dealer failed to amend initial application to include management or control agreements).

inaccuracy and one for the failure to correct that inaccuracy.[14] The Commission is also willing to impose a form of double penalty upon those brokers who are disciplined by it, or who are enjoined by a court and who then fail to amend their registrations to reflect the sanction or injunction. The Commission has imposed a new sanction based, in part, upon a broker's failure to report in a registration amendment the imposition of the former sanction or injunction.[15]

The Rule 15b3-1 [17 C.F.R. § 240.15b3-1] requirement for amending inaccurate registration demands that the amendment be "promptly" filed by the broker-dealer.[16] In addition, Form BD warns, at the top of the form, that "failure to keep this form current and to file accurate supplementary information on a timely basis . . . would violate the Federal securities laws and the laws of the jurisdictions and may result in disciplinary, administrative, injunctive or criminal action."[17] While the term "promptly" is not defined by Commission rule, the Commission has advised that "an amendment to Form BD filed beyond 30 days from the change in information cannot be considered 'promptly' filed in accordance with Rule 15b3-1 [17 C.F.R. § 240.15b3-1]."[18] Accordingly, the Commission was willing to sustain disciplinary action taken against a broker-dealer for, among other matters, failing to file until 49 days had passed, an amendment to its Form BD indicating that the broker-dealer had agreed to change clearing brokers.[19]

Absence of intentionality is not a defense to a failure to file an updating amendment. The Commission has found willful violations of its registration amendment requirements even in the absence of

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[14]Id.

[15]See In re Lloyd D. Sabley & Louis Goldblatt, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶¶ 79,562, 83,540–83,541 (Nov. 1, 1973); In re Michael Levinson & Co., Admin. Proc. File No. 3-6581, Exchange Act Release No. 23,295 (Nov. 14, 1985). See also In re Shiner, King, & Wellesley Financial Services, Admin. Proc. File No. 3-6759, Exchange Act Release No. 23862 (Dec. 3, 1986) (registration revoked by broker-dealer which failed to promptly amend Form BD to reflect felony convictions of its two principal officers and owners).

[16]Rule 15b3-1(a) [17 C.F.R. § 240.15b3-1(a)].

[17]See Form BD, infra, Appendix 2.02.

[18]In re Application of First Guarantor Securities, Inc., Exchange Act Release No. 32725 1993 WL 307526 (Aug. 6, 1993). The National Association of Securities Dealers has notified its members that "[s]ince the form [BD] does not specify a time for filing, a general rule of thumb has developed that filing is required within 30 days." NASD Notice to Members No. 91-11 (Feb. 1991).

[19]Id.