# A BILL TO REDUCE REGULATORY COSTS AND BURDENS ON THE SALE OF PRIVATELY OWNED BUSINESSES

## URGENT NEED

- An estimated $10 trillion of privately owned businesses will be sold as baby boomers retire.
- Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses.
- Business brokers play an important role in facilitating business sales between private parties.
- Multiple layers of regulation unnecessarily increase the cost of professional business brokerage services.
- Simplified securities regulation of business brokers will better protect business owners.

## BACKGROUND

Professional business brokers—also called merger and acquisition (M&A) brokers—introduce buyers and sellers, help to prepare and value the business for sale, assist with the pre-purchase investigation process, advise about the terms and structure of the sale, and help the parties close the transaction. Extremely small transactions are often accomplished through the sale of the business's assets, which is generally not subject to securities regulation. However, when for various business reasons ownership is transferred by means of a sale, exchange, issuance of stock or other securities, or business combination (e.g., a merger), then federal and state securities laws apply to the parties, the transaction, and regulate the activities of the business broker. Securities laws require the business broker to be registered and regulated as a "broker-dealer" by the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and one or more states just like Wall Street investment bankers and stock brokers buying or selling the securities of publicly traded companies—even though these business brokers and the private buyers and sellers they serve are in vastly different circumstances and the smaller size of the transaction cannot support these compliance-related costs.

The cost of complying with current requirements is substantial and is passed on to the business sellers and buyers who use the business broker's services. Minimum transaction fees charged by registered broker-dealers often begin at $500,000 and go higher. Smaller business owners cannot afford to use registered broker-dealers. Instead, they often turn to lower-cost unregistered brokers or simply forego these professional services. This is unfortunate because for many owners the sale of their business is a once-in-a-lifetime event and it represents their retirement "nest egg." Under some circumstances, the business sale may be put at risk of a buyer's later lawsuit to rescind and unwind the transaction because the seller used an unregistered broker.

Business brokers—themselves small businesses—are heavily burdened by the cost of complying with federal broker-dealer regulation. Applying for and obtaining FINRA membership typically takes six to nine months. Initial set-up and compliance-related costs may exceed $150,000. On-going compliance costs may exceed $75,000 per year regardless of the number of securities-regulated business sale transactions closed by the broker in any year. Unregistered business brokers handling securities-regulated transactions avoid those costs but violate both federal and state securities laws, subjecting them to regulatory sanctions, fines and penalties, as well as potential civil liabilities. Because today's "one-size fits all" system of broker-dealer regulation is largely irrelevant to brokering the sale of privately owned businesses, it is widely misunderstood by private business owners and ignored by many business brokers. Most business brokers are already subject to, and do comply with, state real estate brokerage and business brokerage licensing laws. The overlay of federal securities regulation of the same activities is unnecessarily burdensome and diverts the limited resources available to the SEC and FINRA to regulate Wall Street investment bankers and traditional retail brokerage firms.

A proposal to "right-size" federal regulation of business brokers has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Industry Forum on Small Business Capital Formation hosted by the SEC (http://sec.gov/info/smallbus/sbforum.shtml). The Final Report of the Advisory Committee on Smaller Public Companies (2006), reached the same conclusion in Recommendation IV.P.6, page 81 (www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf), as did the Report and Recommendations of the Private Placement Broker-Dealer Task Force of the Business Law Section of the American Bar Association, 60 *Business Lawyer* 959-1028 (2005) (www.sec.gov/info/smallbus/-2009gbforum/abareport062005.pdf). The Alliance of Mergers & Acquisition Advisors (AM&AA), supported by the International Business Brokers Association and 14 other professional associations, has been cooperatively working with the SEC Division of Trading and Markets staff and state securities regulators to formulate a solution through rulemaking, but the SEC's priorities continue to be driven by the Dodd-Frank and JOBS Acts. A solution is urgently needed.

## REQUESTED ACTION

**Introduce and champion a bill to reduce regulatory costs and burdens on private business sales by "right-sizing" federal securities regulation of business brokers**. Proposed statutory language is attached. Additional background information is available upon request.

J. Michael Ertel, Task Force Co-chair (813) 864-6600
Alliance of Mergers & Acquisitions Advisors
200 East Randolph Street, 24th Floor
Chicago, Illinois 60601
mertel@legacymandaadvisors.com

Shane B. Hansen, Partner (616) 752-2145
Warner Norcross & Judd LLP
111 Lyon Street, N.W. – Suite 900
Grand Rapids, Michigan 49503-2487
shansen@wnj.com

Rev. 3/25/13

Warner Norcross & Judd LLP
ATTORNEYS AT LAW

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Section 3(a)(4)(A) of the Securities Exchange Act of 1934, as amended, defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others". Section 15(b) requires a broker to be registered with and regulated by the Securities and Exchange Commission ("Commission") unless a registration exemption is available. To reduce the cost to privately owned business sellers and buyers of professional business brokerage services, a new subsection 15(b)(13) would create a federal transaction-based "M&A broker" registration exemption, while better protecting the public through a simple internet-based public notice filing system, Commission-prescribed disclosures, and coordination with state securities regulation. Explanatory notes appear in brackets and footnotes, which would not appear in the statutory amendment itself.



(13) *Merger and Acquisition (M&A) brokers*—

(A) *Definition*—An "M&A broker" is a broker engaged in the business of effecting the transfer of ownership of a privately held company[1] through the purchase, sale, exchange, issuance, repurchase, or redemption of, or business combination involving, its securities where upon consummation of the transaction the acquiror, acting alone or in concert, will control and, directly or indirectly, will be active in the management of the company.

For purposes of this definition, control means the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. There is a presumption of control for any person that (i) is a director, general partner, or officer exercising executive responsibility (or having similar status or functions); (ii) has the right to vote 25 percent or more of a class of voting securities or the power to sell or direct the sale of 25 percent or more of a class of voting securities; or (iii) in the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 25 percent or more of the company's capital.

(B) *Notice Filing*—

(i) *Contents of Notice*—In lieu of registration with the Commission under paragraphs (b)(1) or (b)(2) of this section, an M&A broker may electronically file with the Commission a notice in such form and containing such information concerning the M&A broker and persons associated with the M&A broker as the Commission may prescribe. The Commission shall make the information provided in the notice publicly available on the Commission's website. The notice shall be updated when its contents becomes inaccurate or incomplete in any material respect. The Commission may require an M&A broker to deliver a disclosure document to its clients describing the M&A broker and its affiliates, associated persons, services, fees, and any conflicts of interest, and such other information as the Commission deems appropriate.[2] The Commission shall through rulemaking implement this subsection within 180 days after enactment.

(ii) *Immediate effectiveness*—Such notice, if properly completed, shall become effective upon its receipt by the Commission; provided, such notice shall not become effective without the Commission's prior approval if the M&A broker or a person associated with the M&A broker is subject to—

(I) Suspension or revocation of registration under paragraph (b)(4) of this section;

(II) A statutory disqualification as defined in Section 3(39) of this title; or

(III) Disqualification provisions under the rules adopted by the Commission pursuant to Section 926, *Disqualifying Felons and Other "Bad Actors" From Regulation D Offerings*, of the Dodd-Frank Wall Street Reform and Consumer Protection Act with respect to the dis-

[1] *[To be defined as an issuer not having any class of securities that is registered, or is required to be registered, with the Commission under Section 12(g) of this title or with respect to which the issuer files, or is required to file, periodic information, documents, and reports under Section 15(d) of this title.]*

[2] *[These disclosure concepts are based on current investment adviser regulation. Today, there are no similar disclosure requirements under existing broker-dealer regulation.]*

qualification of offerings and sales of securities made under section 230.506 of title 17, Code of Federal Regulations.

(C) *Exclusions*—An M&A broker may not in reliance upon this subsection—

(i) Engage on behalf of the seller or acquiror of the company's securities in effecting a transaction when the higher of the following conditions is exceeded—[3]

(I) The company's earnings before interest, taxes, depreciation and amortization[4] for the fiscal year immediately preceding the engagement is more than $25 million determined in accordance with the company's historical financial accounting records[5]; or

(II) The company's gross revenue for the fiscal year immediately preceding the engagement is more than $250 million[6] determined in accordance with the company's historical financial accounting records.[7]

(ii) Directly or indirectly receive, hold, transmit, or have custody of any party's funds or securities related to the transaction.

(iii) Engage on behalf of an issuer in a public offering of any class of securities that is registered, or is required to be registered, with the Commission under Section 12(g) of this title or with respect to which the issuer files, or is required to file, periodic information, documents, and reports under Section 15(d) of this title.

(D) *Exemptions*—An M&A broker notice-filed with the Commission pursuant to subparagraph (B) shall be exempt from (i) all requirements of this title and related rules applicable to a broker registered or required to be registered under section 15(b), and (ii) the Securities Investor Protection Act of 1970[8] in so far as its activities are within the scope defined in subsection (A), except that the following requirements shall still apply:

(i) *[Insert language cross-referencing the preservation of broker-dealer antifraud prohibitions]*;

(ii) *[Insert language cross-referencing standards of training, experience, competence, and qualifications for persons associated with a broker under paragraph (b)(7) of this section]*; and

(iii) *[Insert language cross-referencing SEC examination authority and limited recordkeeping requirements appropriate to an M&A broker's scope of activities, including basic business records, compliance-related records, M&A transaction closing records, and a complaint file]*.

(E) *State Notice Filing*—If required under applicable state law, an M&A broker shall electronically submit a complete copy of the notice as filed with the Commission to each state administrator having jurisdiction. This section shall not affect state law or any exemptions available under state law with respect the activities of an M&A broker.

(F) *Coordination with the States*—In establishing appropriate uniform and consistent standards of training, experience, competence, and qualifications for persons associated with a broker pursuant to section 15(b)(7) of this title, and in prescribing the content of the notice filing under subparagraph (B) above, the Commission is authorized to cooperate, coordinate, and share information with any association composed of duly constituted representatives of State governments whose primary assignment is the regulation of the securities business within those States.



[3] *[It is critically important to be able to make a determination about the qualifying criteria before an engagement begins, rather than when an engagement ends at a transaction's closing, before all of the professional services are performed.]*

[4] *[This concept is commonly referred to as "EBITDA" and can be readily determined from a company's financial statements.]*

[5] *[Financial statements of smaller companies may or may not be prepared on the basis of generally accepted accounting principles (GAAP) but, instead, may follow another recognized comprehensive basis of accounting (OCBOA) such as a statutory basis of accounting, income-tax-basis, cash-basis, and modified-cash-basis.]*

[6] *[In some industries, such as to retail grocery stores, the gross sales are very high but the profit margins are very low. The threshold has been proposed with a broad range of industries and businesses in mind.]*

[7] *[Gross revenue represents a reasonable approximation of a company's size and can be readily determined from a company's financial statements.]*

[8] *[The SIPA requires membership in, and payment of assessments to, the Securities Investor Protection Corporation; an M&A broker would be precluded from handling securities, so the SIPA's requirements are an unnecessary cost.]*

(G) *Rulemaking*—Within 180 days after enactment, the Commission shall through rulemaking implement this subsection and codify the interpretive guidance issued by the staff in the no-action letters to *Country Business, Inc*., 2006 SEC No-Act. LEXIS 669 (Nov. 8, 2006); and *International Business Exchange Corporation*, 1986 SEC No-Act. LEXIS 3065 (Dec. 12, 1986) defining when registration as a broker under Section 15(b) is not required.

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