

**S. 1923 and H.R. 2274**  
***The Small Business Mergers, Acquisitions, Sales,  
and Brokerage Simplification Act***

**Highlights and History**

**U.S. House of Representatives – H.R. 2274**

1. June 6, 2013 - introduced by Congressmen Bill Huizenga (R-MI) and Brian Higgins (D-NY) and referred to the U.S. House Committee on Financial Services (“House Financial Services Committee”)  
<http://huizenga.house.gov/>  
<http://higgins.house.gov/>  
<http://financialservices.house.gov/about/>
2. June 12, 2013 - Hearing - Capital Markets and Government Sponsored Enterprises  
<http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=336906>
3. October 23, 2013 - Hearing - Capital Markets and Government Sponsored Enterprises  
<http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=355850>
4. November 14, 2013 - amended and unanimously passed (57-0) the House Financial Services Committee  
<http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=360865>
5. January 14, 2014 - unanimously passed (422-0) the full U.S. House of Representatives and referred to the U.S. Senate  
<https://www.govtrack.us/congress/votes/113-2014/h14>
6. More information about H.R. 2274 is available at:  
<http://thomas.loc.gov/cgi-bin/bdquery/z?d113:hr2274>

**U.S. Senate – S. 1923**

1. January 14, 2014 - introduced by Senators Joe Manchin III (D-WV) and David Vitter (R-LA) and referred to the Senate Committee on Banking, Housing, and Urban Affairs (“Senate Banking Committee”). Additional co-sponsors to date include Saxby Chambliss (R-GA), Thomas Coburn (R-OK), John Barrasso (R-WY), Tim Scott (R-SC), Pat Toomey (R-PA), Jim Inhofe (R-OK), Angus King (I-ME), and Amy Klobuchar (D-MN).  
<http://www.manchin.senate.gov/>  
<http://www.vitter.senate.gov/>  
<http://www.banking.senate.gov/public/>
2. More information about S. 1923 is available at:  
<http://thomas.loc.gov/cgi-bin/bdquery/z?d113:s1923>

## **Key Points**

- ✓ S. 1923 - H.R. 2274 would simplify, bring clarity, and reduce the regulatory costs of federal securities regulation of business brokerage services in privately negotiated business mergers, acquisitions, and sales of small and mid-sized businesses.
- ✓ Today's "one size fits all" system of federal securities broker-dealer regulation applies to "Main Street" M&A advisors, intermediaries, and business brokers ("M&A brokers") advising small business owners about their privately negotiated business sales the same way as "Wall Street" investment bankers advising public companies.
- ✓ The complexity of federal broker-dealer regulation leaves most M&A brokers, business sellers and buyers, and even their lawyers to wonder how and why this regulation applies.
- ✓ The substantial regulatory costs of today's federal broker-dealer regulation are necessarily passed on to the sellers and buyers who use these professional services.
- ✓ Important protections for "investors" – i.e. business sellers and buyers – are unaffected by this legislation, further described below. Notably, this is just an exemption from registration; the SEC retains jurisdiction to investigate complaints and bring enforcement actions. State securities and licensing laws are also unaffected. Business sellers and buyers are typically represented by legal counsel in privately negotiated business transactions.

## **M&A Transaction Context**

- ✓ Owners of small, mid-sized, and family-owned businesses will retire, resulting in the transition or sale of ownership or closing the business. An estimated \$10 trillion of privately owned businesses will be sold or closed by baby boomers.
- ✓ Many entrepreneurs want to acquire and run their own businesses. Many existing businesses want to grow through acquisitions.
- ✓ M&A brokers play a critical role in facilitating privately negotiated M&A and business sales.

## **Business Brokerage Services**

- ✓ Sellers and buyers need and rely upon professional business brokerage advice and related services not provided by lawyers and accountants.
- ✓ Sellers need professional assistance preparing their business for the sale:
  - Valuing their business,
  - Talking through potential human resource issues when ownership and control changes,
  - Marketing the business,
  - Finding and screening potential buyers,
  - Talking about the pros/cons of possible sale transaction structures,
  - Screening and assessing buyers' competing offers,
  - Preparing for prospective buyers' due diligence,
  - Consulting on a wide range commonly recurring business transition issues.

- ✓ Buyers, including entrepreneurs and companies wanting to grow production, product lines, IP, or distribution through acquisitions need assistance:
  - Finding and screening potential sellers;
  - Assisting with and assessing their due diligence investigation
  - Advising about possible purchase terms and conditions;
  - Anticipating issues with staffing, intellectual property, and business transition issues;
  - Financial modeling;
  - Advising about possible financing alternatives and their impact on profitability; and
  - Buyers are sometimes private equity and venture capital funds.

### **Today's Regulatory System**

- ✓ The exceedingly broad statutory definition of “broker” — “any person engaged in the business of effecting transactions in securities for the account of others” — typically applies to the activities of an M&A broker.
- ✓ The sale of a business's assets for cash is not a securities transaction, but the sale or exchange of a business' stock is a securities transaction, turning an M&A broker into a stockbroker.
- ✓ In order to advise about a stock sale, merger, or business combination an M&A broker must be registered and regulated as a “broker-dealer”. SEC registration also requires, among many things, membership in and regulation by FINRA and extensive initial and on-going compliance obligations that have little to do with the sale of privately owned businesses.
- ✓ The time and cost of broker-dealer registration and on-going compliance are substantial. Initial set-up often exceeds \$150,000. On-going compliance costs often exceed \$75,000 per year, which is prohibitively expensive for M&A brokers, who are themselves small businesses and may handle only one or two stock sale transactions each year because small transactions are commonly structured as cash-for-asset business sales.
- ✓ These compliance-related costs are passed on to the business owners using the business brokerage services, raising the cost of these transactions to the parties.
- ✓ Typical registered investment banking fees are expensive; smaller businesses are not well served by registered investment bankers because the transaction fees are too small.
- ✓ High investment banking fees drive many small and mid-sized business sellers and buyers to engage unregistered M&A brokers.
- ✓ A high percentage of M&A brokers are not registered with the SEC and so, in many instances, are violating the law in the absence of a broker-dealer registration exemption. The SEC staff has issued no-action letters expressing their views about enforcement, but those letters do not have the force of law or SEC-adopted rules.
- ✓ Registration violations may put their clients' transactions at risk, put the M&A brokers' compensation at risk, and expose the M&A broker to regulatory enforcement and sanctions.

## **Public Policy**

- ✓ The public policy considerations supporting this legislation began in 2005 with the American Bar Association, Business Law Section, *Report and Recommendations of the Private Placement Broker-Dealer Task Force*, available on the SEC's website at [www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf](http://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf).
- ✓ A similar recommendation was made in 2006 in *The Final Report of the Advisory Committee (to the SEC) on Smaller Public Companies*, available on the SEC's website at [www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf](http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf).
- ✓ These independent reports prompted the Alliance of Merger & Acquisition Advisors ("AM&A"), International Business Brokers Association ("IBBA"), and M&A Source, all national professional M&A and business broker associations, to seek a solution by drafting and proposing rules to the SEC and the North American Securities Administrators Association (NASAA), the association of state securities regulators, in 2007 and 2008.
- ✓ Appropriately scaling federal regulation of M&A brokers has been among the top recommendations in the 2006, 2007, 2008, 2009, 2010, and 2011 Government-Industry Forum on Small Business Capital Formation, available on the SEC's website at <http://sec.gov/info/smallbus/sbforum.shtml>. This topic was not on the agenda for 2012 or 2013.
- ✓ The SEC staff has been looking at simplifying the regulation of M&A brokers since 2006. The SEC talked with FINRA and we understand that FINRA said it has not observed problems involving registered M&A brokers and that FINRA did not object to the SEC's creating a simplified registration system through rulemaking.
- ✓ Since discussions with the SEC began in 2006, the SEC staff has been supportive but in 2012 informally suggested that the associations go to Congress because the SEC's agenda was full, indeed backlogged, with congressionally mandated rulemaking.
- ✓ S. 1923 - H.R. 2274 represents the culmination of more than seven years' effort to work cooperatively with the SEC staff and NASAA to craft a solution through rulemaking.

## **The Small Business Brokerage Act (S. 1923 - H.R. 2274)**

- ✓ H.R. 2274 was a bipartisan bill introduced on June 6, 2013. As introduced, H.R. 2274 would have directed the SEC to create a simplified system of registration through a public notice filing and regulation relevant to what M&A brokers do.
- ✓ At the October 23, 2013 hearing by the House Financial Services Committee, H.R. 2274 was supported in testimony by the NASAA and the U.S. Chamber of Commerce.
- ✓ At the Committee's November 14, 2013 mark-up meeting, the SEC requested that H.R. 2274 be amended to create an exemption from registration, rather than a simplified notice-filing registration and tailored regulation. The SEC did not object or raise concerns with any other provisions in the bill. With the SEC's requested changes, H.R. 2274 unanimously passed (57-0) the Committee.

- ✓ On January 14, 2014, H.R. 2274 unanimously passed (422-0) the full U.S. House of Representatives and was referred to the U.S. Senate.
- ✓ On the same day, January 14, 2014, an identical bipartisan companion bill, S. 1923, was introduced in the U.S. Senate by Senators Joe Manchin III (D-WV) and David Vitter (R-LA) and referred to the Senate Banking Committee.
- ✓ On January 31, 2014, the SEC issued the “M&A Broker” no-action letter stating that the staff would not recommend an enforcement action if, under specified conditions, an M&A broker did not register as a broker-dealer with the SEC. Those conditions are similar to the conditions in S. 1923 - H.R. 2274. The no-action letter further evidences the staff’s view that a registration exemption is appropriate. The SEC’s no-action letter is available at: <http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf>

### **Covered M&A Broker Activities**

- ✓ The M&A broker registration exemption applies only in the context of an M&A transaction where the buyers will “control” and be active in running the business after the sale.
- ✓ An “M&A broker” is defined by the characteristics of the buyer and the transaction:
  - Covers the transfer of ownership of an *eligible privately held company*,
  - In a transaction involving securities or assets of the target company,
  - If the broker reasonably believes that buyer will, directly or indirectly:
    - § *Control* and
    - § Be active in the management of the business;
- ✓ “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 who—
    - § Is a director, general partner, member or manager of a limited liability company, or officer exercising executive responsibility (or has similar status or functions);
    - § Has the right to vote 20 percent or more of a class of voting securities or the power to sell or direct the sale of 20 percent or more of a class of voting securities; or
    - § In the case of a partnership or limited liability company, has the right to receive upon dissolution, or has contributed, 20 percent or more of the capital.
- ✓ An “*Eligible Privately Held Company*” (i.e., the target company to be acquired) must:
  - Have no class of publicly registered securities; and
  - Its last year-end financial statements must show either or both:
    - § EBITDA of less than \$25,000,000; and/or
    - § Gross revenues of less than \$250,000,000.

### **Continuing “Investor” (Seller/Buyer) Protections**

- ✓ While S. 1923 - H.R. 2274 would exempt M&A brokers from SEC registration and FINRA membership, important investor protections would be preserved and cost-effectively balanced with promoting economic growth through the sale of businesses.

- ✓ Federal securities laws, including antifraud prohibitions and SEC jurisdiction to investigate and bring enforcement actions, would continue to apply to M&A brokers. State regulation of securities, real estate, and business brokerage services would be unaffected.
- ✓ M&A brokers could not have custody of the funds or securities exchanged by the parties.
- ✓ M&A brokers could not be engaged by an issuer to distribute securities in a public offering of its securities or in capital-raising from passive investors.
- ✓ Unlike passive investors, business sellers control and actively manage the business, so they intimately understand what they are selling. Business buyers conduct their own pre-purchase investigation because they will control and run the business after the sale.
- ✓ The seller and buyer are both typically represented by legal counsel in structuring, negotiating, and closing M&A transactions. Other advisors such as CPAs and tax advisors are often involved.
- ✓ In larger transactions, the parties are experienced and sophisticated in owning and running businesses and have teams of executives, managers, and employees involved.
- ✓ The parties primarily rely upon their negotiated contract rights for their protection in the M&A transaction, not securities laws or securities regulators.

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For more information, you can contact:

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## **PARTIAL LIST OF SUPPORTING ORGANIZATIONS**

### **National and International**

Alliance of Merger & Acquisition Advisors (AM&AA)

<http://www.amaonline.com/>

International Business Brokers Association (IBBA)

<http://www.ibba.org/>

M&A Source

<http://www.masource.org/>

Association for Corporate Growth (ACG)

<http://www.acg.org/>

Institute of Certified Business Counselors (ICBC)

<http://www.theicbc.org/>

Mid-Market Alliance (MMA)

<http://www.midmarketplace.com/>

Small Business Investor Alliance (SBIA)

<http://www.sbia.org/>

### **Regional and Local**

Midwest Business Brokers & Intermediaries (MBBI)

Business Brokers of Florida (BBF)

Colorado Association of Business Intermediaries (CABI)

Mid-Atlantic Business Intermediaries Association (MABIA)

Texas Association of Business Brokers (TABB)

California Association of Business Brokers (CABB)

Arizona Business Brokers Association (AZBBA)

Georgia Association of Business Brokers (GABB)

Michigan Business Brokers Association (MBBA)

Nevada Business Brokers Association (NBBA)

Carolinas - Virginia Business Brokers Association (CVBBA)

New England Business Brokers Association (NEBBA)

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