

**CONCEPT OUTLINE FOR NASAA
TO DEVELOP A STATE BROKER REGULATORY REGIMEN
FOR CERTAIN BUSINESS BROKERS AND M&A INTERMEDIARIES**

The U.S. economy depends heavily upon the growth of small businesses. Critical to their success is the ability of business owners to sell their enterprises in order to liquidate their investments. Equally so, existing businesses and entrepreneurs must be able to locate and acquire small business enterprises that are available for sale. Both sellers and buyers need intermediaries and professional advisors to facilitate those transactions. With the impending retirement of millions of baby boomers, the number of such transactions on the horizon is enormous. Jobs creation and preservation are critically important to both federal and state government.

Today there exists substantial uncertainty about the permissible role of intermediaries who are not registered as a “broker” or “broker-dealer” under federal and state securities laws in connection with a business purchase or sale transaction that may involve securities (referred to as “**M&A Brokers**”). A large number of M&A Brokers never become involved in capital-raising activities. They merely “broker” the sale of a business, which could take the form of an asset sale or the form of a stock sale. Prospective sellers and buyers of businesses need competent, professional, financial advice to understand all of the alternatives available for structuring their proposed transaction, and assistance in implementing the transaction regardless of whether that structure starts or ends as a stock sale or an asset sale. Buyers and sellers benefit from an M&A Broker’s extensive network of business contacts and understanding of how and where to effectively market a business that may be for sale. Imposing today’s substantial cost of full broker-dealer registration and regulation upon M&A Brokers, particularly those whose business primarily involves smaller transactions, raises serious public policy concerns that adversely affect the health of our economy.

These public policy concerns have been expressed from several perspectives, including the Private Placement Broker-Dealer Task Force of the Business Law Section of the American Bar Association (“**PPBD Task Force**”), the SEC’s annual Government-Business Forums on Small Business Capital Formation (“**SEC Small Business Forums**”), and the Final Report of the Advisory Committee on Smaller Public Companies dated April 23, 2006 (the “**SEC Advisory Committee Report**”).¹ As explained in the PPBD Task Force Report, the existing broker-dealer registration, testing, and regulatory structure are not designed to address these kinds of business activities. However, because those requirements are driven by a broker’s registered status, compliance necessitates each firm’s deployment of substantial financial, managerial, and staffing resources to tasks that are irrelevant to these activities and do little to further public or investor protection. This proposal seeks to harmonize the application of federal and state securities laws with the unregistered activities of several thousand Intermediaries.

This is an outline, from the state securities law perspective, discussing the concepts that could form the basis for coordinated federal and state rulemaking to address these concerns affecting M&A Brokers who are never engaged in capital-raising activities. There is a wide range of possible approaches. For example, since 1974 California has used a very simple

¹ The PPBD Task Force Report and SEC Advisory Committee Report accompany this proposal.

exemption from state broker-dealer licensing under Rule 260.204.5, *Merger and acquisition specialists*:

An exemption from the provisions of Section 25210 of the Code is hereby granted, as being necessary and appropriate in the public interest and for the protection of investors, to any person who effects transactions in securities in this state only in connection with mergers, consolidations or purchases of corporate assets, and who does not receive, transmit, or hold for customers any funds or securities in connection with such transactions.

(Emphasis added). Recognizing that, for the SEC and most other states, we are proposing a quantum leap from full broker-dealer registration and regulation, we believe the following concepts would address the principal concerns that most regulators would have in relaxing requirements currently applicable to M&A Brokers.

As an initial step, this proposal has been presented to the North American Securities Administrators Association (“NASAA”) because of the necessity for coordinated federal and state regulatory action to accomplish this proposal’s objectives. A similar, but separate, proposal from the federal perspective has been presented to the staff of the Securities and Exchange Commission (“SEC”).

The proposed coordinated rulemaking would create a limited federal exemption from broker registration under the Securities Exchange Act of 1934, as amended, that is conditioned upon a complementary regimen of state regulatory filings for a business broker, professional M&A advisor, CPA (acting as an intermediary), attorney (acting as an intermediary), or business intermediary (each an “**M&A Broker**”) who, for transaction-based compensation, is involved with the purchase or sale of a business and common types of mergers and acquisitions in a wide range of transaction structures. Consequently, under the proposal, the M&A Broker would not be required to become an NASD member nor would be subject to those extensive and constantly evolving regulatory requirements applicable to the entire securities industry. As described below, state rulemaking would complement the federal exemption to create a regulatory regimen that fits the role of many Intermediaries in the purchase and sale of existing businesses—which has changed relatively little over the years, in contrast to the securities industry as a whole. The states would play a critical role as the “local cops on the beat” in monitoring and policing these regulated activities that are predominately local in nature. There is, however, a compelling need for a consistent approach by the states because, in today’s marketplace, Intermediaries often deal with clients and parties whose operations may be located in different and even multiple states.

The limited federal broker registration exemption, and corresponding state requirements, would only apply to an M&A Broker involved in the purchase or sale of a business or business unit (e.g., a whole business or a discrete business line, division, department, or specific assets; if corporately held, a subsidiary, corporation, limited liability company; collectively, referred to as the “**Business**”) where the buyer intends to exercise control over, or

be personally involved in, the management or operation of the Business. The proposed federal broker registration exemption and state requirements would not extend to capital-raising activities, which are addressed by the PPBD Task Force's proposal. The proposal would not affect other state laws and related rules which may concurrently apply to Intermediaries in some transactions, such as real estate licensing laws.

Background and Context

The limited federal broker registration exemption, together with the related state requirements, that we recommend is designed to enhance public protection. Public protection would be enhanced by bringing about a substantially greater level of industry compliance with regulatory requirements that are designed to fit the activities of an M&A Broker whose business does not include capital raising or related investment banking. These types of limited activities, and the compensation received by Intermediaries for their services, particularly in smaller transactions, do not support the commitment of substantial financial, managerial, and educational resources associated with full broker-dealer registration and regulation or even the limited PPBD exemption proposed by the PPBD Task Force. Many of these Intermediaries conclude a small number of deals each year but work on them intensely for many months. Other Intermediaries may develop a long-term relationship with small business owners over many years as the businesses are groomed for future sale. In light of those substantial costs, if existing broker-dealer registration and regulation are vigorously enforced, the services provided by these Intermediaries will be driven from the marketplace, leaving buyers and sellers of small businesses without professional advice or assistance.

This proposed exemption would serve the interests of both small business owners and Intermediaries by (1) clarifying the permissible role of competent professional advisors in business sales and M&A transactions, (2) assuring the parties that their transaction is not subject to later rescission under federal or state securities laws solely because the M&A Broker is not registered as a broker-dealer, and (3) assuring the M&A Broker that its engagement and transaction-related compensation are not voidable under those securities laws. Existing SEC no-action letter guidance, such as the SEC's recent letter to *Country Business, Inc.* dated November 8, 2006 ("CBI"), and earlier letter to the *International Business Exchange Corporation* dated December 12, 1986 ("IBEC") (including other no-action letters that have been either denied or withdrawn), as well as enforcement cases and anecdotal reports that have come to form a patchwork of "regulatory lore," do not adequately nor clearly address the wide variety of facts and circumstances that daily face Intermediaries, buyers and sellers of businesses, and their legal counsel. Many states have not been asked, nor addressed, these kinds of questions at the state level. Moreover, the CBI and IBEC no-action letters permit only a limited role for an intermediary when a business sale involves the transfer or issuance of stock among the parties. The buyers and sellers of businesses are better served when the full range of an intermediary's knowledge, skills, and services are available, regardless of how the transaction is structured to accomplish the parties' business objectives.

The necessity for regulatory action to address the role of intermediaries in serving various aspects of small business capital formation has been the leading topic at the SEC Small

Business Forums in each of 2004, 2005, and again in 2006. One aspect of the discussion to date has been the need to address the role of “finders” in capital raising by small businesses, as noted by Alan L. Beller, formerly Director of the SEC’s Division of Corporation Finance, on September 23, 2004, in testimony before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, United States House of Representatives. This call to action was also raised in Recommendation IV.P.6. (page 81) of the SEC Advisory Committee’s Final Report. The Committee’s report notes the recommendations of the PPBD Task Force as published in the Business Lawyer, 60 Bus. Lawyer 959-1028 (May 2005). With respect to the role of Intermediaries in brokering the purchase and sale of a business, the PPBD Task Force Report states:

The need for full broker-dealer registration of entities or individuals involved solely in the match-making to permit merger and acquisition brokerage activities is not apparent to us. We believe that the vast preponderance of this activity occurs by non-registered persons, and that there is little history to warrant a requirement for full broker-dealer registration.

(Part I, Section II C, *Adoption of Rules or Issuance of a Clarifying Release Relating to Business Brokers*, page 4.)

The Alliance of Merger and Acquisition Advisors (AM&AA), an international association of merger and acquisition professionals headquartered in Chicago, Illinois, has been working closely with three other national and international professional associations to seek a regulatory solution to these issues. Together, the membership of these four professional associations number several thousands and their member firms are involved with thousands of transactions every year, representing a wide range of deal sizes and structures. Some of these member firms are fully-registered broker-dealers and others are not. The AM&AA is fully supportive of the PPBD Task Force proposal and, if the proposal is implemented, many of its member firms would likely become registered under the PPBD regimen. The activities of other member firms are more limited, and the limited broker registration exemption outlined here would be more appropriate and permit them to better and more efficiently serve the needs of their small business clients.

This concept outline is intended to serve as a starting point for discussion and development by NASAA of a coordinated rulemaking proposal for consideration by its member states, including proposed model rules and related commentary under the Uniform Securities Act of 2002, as well as the Uniform Securities Act of 1956. State administrators’ statutory authority to implement the proposal may vary and will need to be coordinated with the specific requirements of the securities laws in each state. As will be evident from the concepts presented below, a coordinated regulatory approach is central to the proposal and the efficient allocation of federal and state regulatory resources.

The proposed limited broker registration exemption would not affect the public and investor protections under the anti-fraud prohibitions and remedies or the securities

registration and exemption requirements under federal and state securities laws. The conditions and requirements of the proposed exemption would not, however, be applicable to any transaction that was not subject to federal or state securities laws (e.g., most “asset deals” do not involve the transfer or issuance of securities).

We believe that the implementation of this proposal—with the articulation of well-defined standards of application—would result in hundreds, if not several thousands, of Intermediaries coming into compliance with federal and state securities laws with respect to their currently unregistered activities. As described below, compliance would require filings with the states and thus put these Intermediaries “on the radar screen” for purposes of regulatory supervision. It is in the public interest for voluntary compliance to be encouraged. For the reasons more fully articulated in the PPBD Task Force Report, Part II, Section V, *Encouraging Registration*, we recommend that, for a reasonable period of time after rulemaking, the state filing process should not focus on prior unregistered activities by requiring affirmative representations or attestations from filers—sometimes called “come clean” letters. A number of states do not presently impose such registration-related requirements. No public purpose is advanced by imposing an industry-wide burden of analyzing thousands of historical transactions under federal and state securities laws in order to represent that there have been no prior unlawful unregistered activities. Of course, apart from registration issues, prior acts of misconduct punishable under antifraud prohibitions would not be excused. If the SEC or a state regulator later learns of improper conduct, by reason of complaint or inspection, the full range of regulatory powers would be available to investigate and address those compliance issues.

Some of the points noted below are informational only and would not need to be included in the language of the rules creating the proposed federal broker registration exemption or state broker regulatory filing requirements. Various concept points in the proposal are grouped by their subject matter for discussion purposes.

Characteristics of the M&A Broker

1. The SEC and each state securities administrator have jurisdiction over the M&A Broker in connection with the purchase/sale of a Business involving securities (a “**Regulated Business Transaction**”) under the existing scope of applicable federal and state securities laws. The M&A Broker would make an annual notice filing, on a short form prescribed by the state—hopefully a uniform form developed by NASAA. Recognizing that advertising the availability of a Business for sale often occurs over the Internet and that inquiries and expressions of interest often come from many different jurisdictions without ever coming to fruition, the filing would be made not later than 5 business days prior to the actual closing of a Regulated Business Transaction (the “**Transaction’s Closing**”) triggering this exemption’s filing requirements in each applicable state jurisdiction. Individuals employed by the M&A Broker and acting within the scope of their employment (or engagement as an independent contractor) would be covered by the firm’s state filing(s) (either as a corporate entity or a sole proprietorship). The firm’s annual filing fee would be determined by, and paid to, each state to help fund the regulatory regimen in each jurisdiction.

2. Through the notice form, the M&A Broker would consent to service of process and appoint the state securities administrator as its agent for service of process.
3. The M&A Broker would be required to be solvent under applicable state laws. There would not be a minimum capital requirement nor a bonding requirement.
4. The exemption would not be available if the M&A Broker or any affiliate, director, officer, employee, independent contractor representative, or other representative (“**M&A Broker’s Associated Persons**”) is a person with a statutory “bad boy” disqualification; however, upon receipt of a satisfactory explanation, a regulator having jurisdiction (or the regulator imposing the disqualification) could waive that disqualification within the scope of that regulator’s jurisdiction or impose conditions on the individual’s participation in Regulated Business Transactions. The firm-level form filed with the state would annually certify that neither the M&A Broker nor the M&A Broker’s Associated Persons are subject to such a statutory disqualification (or that any existing disqualification had been appropriately waived by regulatory order).
5. No individual-level testing, licensing, registration, or notice filing would be required under applicable securities laws. There would be no individual registration, examination, or financial qualifications for personnel such as a NASD registered principal (Series 24) or registered representative (Series 7). The individuals’ education, business experience, and professional credentials would be outlined in the Engagement and Conflict Disclosures described in paragraphs 9, 10, and 11 below.
6. There would be no annual audit required and no financial reporting (e.g., FOCUS reports or annual financial statements). The M&A Broker’s accounting and financial records would be maintained and available for examination and inspection by the SEC and states, as described below.
7. The M&A Broker would create and keep current a complaint file to retain all written complaints and disputes pertaining to Regulated Business Transactions, which would be maintained with other required books and records for examination and inspection as described below.

Nature of the Engagement

8. The M&A Broker’s intended scope of services and basis for compensation would be described in a written engagement with the seller or buyer, as applicable. The engagement document would be maintained with other transaction-related records as described below. If the structure of an asset transaction changed before closing and became a Regulated Business Transaction (e.g., a shareholder sale of stock instead of a corporate sale of assets), the written engagement would still permit the M&A Broker to recover compensation for services described in the engagement from whoever is, ultimately, the “seller/client.”

9. The M&A Broker's role, relationships, terms of compensation, and any known or reasonably anticipated conflicts of interests would be disclosed in writing to the M&A Broker's client (disclosures could be in the engagement letter or a separate disclosure document) (the "**Engagement and Conflict Disclosures**"). This document would also include contact and background information about the firm, as well as education, business experience, and professional credentials of its representatives. The M&A Broker would also provide the Engagement and Conflict Disclosures to other parties in the Regulated Business Transaction, but those disclosures would not be required to state the specific amount or method of computing its compensation. Any control or ownership relationships between or among the M&A Broker and any of the parties must be included in the Conflict Disclosures. The document would be provided at the time of the M&A Broker's engagement to assist the client with a Regulated Business Transaction. Recognizing that many proposed transactions evolve as different needs or objectives are identified during the course of an engagement, or upon different parties becoming involved, the Engagement and Conflict Disclosures would be updated not less than five days prior to the Transaction's Closing to reflect any material changes of facts or circumstances. Such changes would not, however, render unlawful the activities previously described in the initial Engagement and Conflict Disclosures and would not void the M&A Broker's right to receive compensation for the services provided.
10. The Engagement and Conflict Disclosures would state that the M&A Broker is relying upon a federal exemption from broker registration and corresponding state broker registration requirements. The Engagement and Conflict Disclosures would include such cautionary statements as: (1) the M&A Broker is not registered as a broker-dealer under federal or state securities laws and is not a member of the NASD; (2) the M&A Broker has filed (or, as applicable, will file) the above-described notice with the applicable state securities administrator(s), together with contact information for those administrator(s); (3) the parties are encouraged to seek their own legal counsel before entering into any binding agreements; and (4) the M&A Broker may or may not, as applicable, have independently verified some or all of the information provided by one party to the other. The M&A Broker's letterhead, business cards, and advertising could state, in words to this or like effect, that it is a "limited registration securities broker."
11. If described in the engagement and, after receiving all of the Engagement and Conflict Disclosures (including compensation), both parties consent in writing, the M&A Broker could act as an independent intermediary with respect to two or more parties in the Regulated Business Transaction.
12. The M&A Broker's compensation may be contingent upon a successful consummation of the transaction regardless of the deal's structure (i.e., whether structured as a transfer of assets or securities). Typically, the compensation would be based on percentage of the purchase price (perhaps including a minimum fixed or retainer fee), plus reimbursement of out-of-pocket expenses). The M&A Broker's compensation could include securities (e.g., stock, options, or warrants) and could have conditions or contingencies. Any

securities received by the M&A Broker as compensation would be subject to all other applicable requirements and restrictions under federal and state securities laws.

13. The M&A Broker would be engaged by its client to assist with the purchase or sale of the Business itself, regardless of the existing form of ownership or the legal structure used in the transaction to convey the ownership (e.g., title to assets, transfer of securities, merger, or other business combination). One or more “Eligible Buyers” (defined in paragraph 18 below) could purchase less than 100 percent of the ownership of the Business; provided, that upon the closing of a Regulated Business Transaction the Eligible Buyer(s) either (i) owns or controls, directly or indirectly, not less than 25 percent of the ownership of the Business and has the ability to control (by contract or otherwise) the Business, either alone or as a group; or (ii) is personally and actively involved in the management or operation of the Business.
14. If in a Regulated Business Transaction all of the conditions to this exemption are met, the M&A Broker may do all of the following transaction-related activities without being registered as a broker, broker-dealer, or agent under applicable federal or state securities laws:
 - Advise its client about the value of the Business, the price, the terms, the structure for the transaction, tax implications, and other transaction-related matters;
 - In “sell-side” engagements, identify prospective Eligible Buyers (defined in paragraph 18 below) and advertise and market the sale of the Business to other Intermediaries, professional advisors (e.g., lawyers, accountants, and bankers), and prospective Eligible Buyers using private and public media such as newspapers, magazines, and the Internet; provided, that the M&A Broker would screen inquiries from prospective buyers and only proceed with those who are reasonably believed to be Eligible Buyers;
 - In “buy-side” engagements, identify prospective sellers to determine their interest in a transaction;
 - In all engagements, contact and meet with the prospective parties to obtain or provide information about the Business and the prospective parties;
 - Negotiate the price, the terms and conditions, and the structure for the transaction on behalf of the M&A Broker’s client;
 - Draft or participate in drafting terms sheets, letters of intent, and definitive purchase agreements on behalf of its client; provided, however, that, for an M&A Broker to engage in these specific activities, legal counsel must also be involved in closing the transaction unless the aggregate consideration to be exchanged is reasonably believed to be valued at less than \$500,000;
 - Organize and assist with any due diligence investigation with respect to the Business and the parties to the transaction;
 - Suggest or recommend sources of possible commercial financing to a buyer; provided, that the M&A Broker has no role and does not receive compensation of any kind with respect to a securities offering to finance any part of the transaction; and

- Conduct or assist with the closing of the transaction, including the delivery of closing documents; provided, that the M&A Broker must not have custody, possession, or handle any funds or securities exchanged in the transaction.
15. As applicable, the M&A Broker's services may include valuing, analyzing, or modeling the revenues, expenses, and financial performance of the Business, payment of the purchase price, or structure of the transaction including, for example, evaluation of historical and projected revenues and expenses, financial modeling and forecasting, benchmarking against comparable businesses and transactions, appraising the Business's assets and liabilities, cash flow analyses, and similar financial matters. These activities would not include or involve any analysis of stock performance in public securities markets. The M&A Broker may also prepare or assist with a client's proposal and/or application to obtain a commercial loan from a bank or commercial lender.
 16. As applicable, the M&A Broker could provide its client (and the client's affiliates) with financial and analytical reports and models pertaining to the Business and its operations, as described in the engagement agreement; provided, that the M&A Broker's document conspicuously states that it is intended for internal use only by the M&A Broker's client and the client's affiliates, as well as their counsel, accountants, bankers, and other professional advisors.
 17. The M&A Broker's compensation could come from fee sharing with other Intermediaries for referring potential buyers and sellers in Regulated Business Transactions that comply with this proposed exemption. The M&A Broker could recommend registered broker-dealers for transactions or activities requiring such registration but could not receive compensation for this type of referral unless and to the extent permitted by NASD Rule 2420. The M&A Broker may, for fully-disclosed compensation (described in the Conflict Disclosures), recommend banks, appraisers, title companies, insurance agencies, and other nonsecurities-related, third-party service providers, subject to compliance with all applicable laws, rules, or regulations pertaining to referrals in those contexts (e.g., insurance licensing).
 18. The M&A Broker would have no involvement in any offer or sale of securities to any person other than to an Eligible Buyer (or to the seller who receives securities as transaction-related consideration) that is incidental to a Regulated Business Transaction. The M&A Broker would document an Eligible Buyer's status through a written certification or representation (such as in the written engagement). Recognizing that for tax and other reasons transaction structures vary widely, in determining who is an Eligible Buyer the Regulated Business Transaction would be viewed as a whole, which could include various related steps taken proximately in time to achieve the Transaction's Closing. An "**Eligible Buyer**" would include:
 - An individual who will be actively engaged, directly or indirectly, in operating or managing the Business (such as a corporate director or officer, LLC manager/member, general partner, or sole proprietor) or who will control the

- management and operations of the resulting business through the election (or contractual power of election) of a majority of the Business's directors/managers;
- An existing business entity;
 - An existing venture capital or equity fund (“**Fund**”); provided, that (i) the Fund has not been formed for the purpose of funding the transaction; (ii) the M&A Broker has no involvement with any securities offering by the Fund to raise debt or equity capital; and (iii) the M&A Broker's affiliation with or interest in the Fund, if any, is described in the Conflict Disclosures; and
 - Any entity formed by an individual or an existing business entity (both as described above) solely to facilitate the transaction; provided, that the M&A Broker is not involved in raising debt or equity capital from any person other than an Eligible Buyer, a Fund, or a commercial lender in the transaction.
19. The M&A Broker would not have custody or possession of funds or securities of a buyer, seller, or other party to the Regulated Business Transaction:
- Any person other than the seller or buyer who is holding, disbursing, or receiving funds or securities must be qualified under applicable federal and state laws (e.g., an insured depository institution, registered and qualified broker-dealer, title insurance company, escrow company); and
 - All proceeds in the transaction would be disbursed through an institution that is subject to anti-money laundering laws (i.e., no currency directly exchanged in the transaction).
20. The M&A Broker would not have authority to legally bind a buyer, seller, or party, or to close a Regulated Business Transaction, without an express written direction from that party.

Nature of the Regulated Business Transaction

21. The offer and sale of securities in a Regulated Business Transaction must comply with applicable registration or exemption requirements under applicable federal and state securities laws and related rules.
22. Only the Business may be advertised or marketed for sale to Eligible Buyers; there would not be any advertising specifically tied to the sale of stock, securities, or other fractional ownership interests in the Business. Advertising could use any form of public media including, for example, newspapers, magazines, and the Internet.
23. Neither the Business nor the Eligible Buyer could be a “public shell company” or “special purpose acquisition company” (i.e., any company whose securities are registered with the SEC but which has no significant assets or operations) or a “blind pool” or a “blank check” company.
24. Records evidencing each Regulated Business Transaction (e.g., M&A Broker's engagement and Conflict Disclosures, definitive agreement, and the principal closing

documents) would be required records. The M&A Broker would be exempt from other record-keeping requirements that are applicable to brokers and dealers (registered or exempt) under the 1934 Act unless specifically made applicable in the exemption's rule.

25. The books and records related to each Regulated Business Transaction, as well as all other books and records within the jurisdiction of applicable securities laws, would be subject to examination and inspection by the SEC and state securities administrators. Books and records would be maintained for not less than the applicable statute of limitations for securities claims in the M&A Broker's home state.

Effect on Other Laws

26. The exemption from registration as a broker, broker-dealer, or agent under federal and state securities laws would not affect registration or licensing requirements applicable to other types of businesses or transactions under other federal or state laws (e.g., business broker, real estate broker, mortgage broker/lender/servicer, bank, or insurance agency).

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