

HR 477

THE SMALL BUSINESS MERGERS, ACQUISITIONS, SALES, AND BROKERAGE SIMPLIFICATION ACT

A bill to amend the Securities Exchange Act of 1934 to exempt from registration brokers who provide services in connection with the transfer of ownership in smaller privately held companies

- *An estimated \$10 trillion of privately owned businesses will be sold or closed as baby boomers retire.*
- *Jobs are preserved and created when new entrepreneurs acquire and grow existing businesses.*
- *Business brokers play a critical role in facilitating private business mergers, acquisitions, and sales.*
- *HR 686 – S 1010 will reduce transaction costs ultimately borne by smaller business sellers and buyers.*

Summary and Status of HR 477

Business sellers and buyers commonly rely upon merger and acquisition (M&A) advisors, and business brokers (M&A brokers) to help them sell or buy a business. HR 477 is a bipartisan bill which was first introduced in the 113th Congress as HR 2274 to clarify, simplify, and reduce regulatory costs associated with the purchase and sale of smaller privately held companies.

As introduced, HR 2274 was supported in testimony by the U.S. Chamber of Commerce, the North American Securities Administrators Association (NASAA) and several independent organizations. During the bill's mark-up before the House Financial Services Committee (HFSC), the Securities and Exchange Commission (SEC) asked that the bill be amended to create an exemption from "broker-dealer" registration for M&A brokers, rather than a simplified system of registration as had been initially proposed. The exemption would be self-effecting upon enactment and no SEC rulemaking would be required. As amended, HR 2274 was reported favorably by the HFSC unanimously (57-0), and unanimously passed (422-0) the U.S. House of Representatives on Jan. 14, 2014.

In the 114th Congress, a successor bill, HR 686, was reported favorably out of House Financial Services Committee on May 20, 2015. A bipartisan companion bill, S 1010, was also pending before the Senate Committee on Banking, Housing, and Urban Affairs, but no action was ever taken. The broker-dealer registration exemption to be created by HR 477 would only apply to M&A transactions involving the sale of privately owned businesses with annual earnings of less than \$25 million

(that is, earnings before interest, taxes, depreciation, and amortization, commonly called EBITDA) and/or annual gross revenues of less than \$250 million. The exemption would only apply where the buyer would, directly or indirectly, control and actively manage the business after the transaction closes.

On Sept. 29, 2015, NASAA North American Securities Administrators Assn.) formally adopted State Model Rule which closely parallels the language in S 1010, and harmonizes state & provincial securities laws with the SEC MAB NAL, but retains the size caps.

Important existing investor protections would be unaffected by HR 477. Federal securities laws, including SEC jurisdiction to investigate and bring enforcement actions, and antifraud prohibitions, would continue to apply to M&A brokers. State regulation of securities, real estate, and business brokerage services would be unaffected. Unlike passive investors, business sellers control and actively manage the business, so they intimately understand what they are selling. Buyers conduct their own pre-purchase investigation; they will control and run the business post-closing. The parties are typically represented by legal counsel in structuring, negotiating, and closing M&A transactions. The parties primarily rely upon their negotiated contract rights for their protection, not securities laws or securities regulators. Accountants, commercial bankers, and other advisers are often involved. In larger transactions, the parties are experienced and sophisticated in running businesses and each have a management team.

Business Brokerage Services – Public Policy Background

Professional business brokerage services are critically important to the liquidity of small business ownership, business growth, and related jobs preservation and creation. M&A brokers introduce business buyers and sellers, help to prepare and value the business, assist with the pre-purchase investigation process, advise about the terms and structure of the sale, and help the parties close their transactions. Very small business sales are usually accomplished as a purchase of business's assets for cash, which is generally not subject to securities regulation. However, when ownership is transferred by a purchase/sale, exchange, or issuance of stock or debt, or a merger or business combination transaction, then federal and state securities laws apply to the parties, the transaction, and regulate the activities of the M&A broker.

Today, securities laws require M&A brokers to be registered and regulated as a "broker-dealer" by the SEC, FINRA, and one or more states - just like Wall Street investment bankers buying or selling publicly traded securities. The cost of complying with existing broker-dealer regulatory requirements is substantial - commonly more than \$150,000 initially and more than \$75,000 annually - and those costs are necessarily passed on to the business sellers and buyers who use the M&A broker's services. Today, typical transaction fees charged by registered M&A brokers are expensive and often smaller communities are not well served by registered firms. Instead, smaller business owners often turn to lower-cost unregistered business brokers, who may be operating in violation of securities laws, or simply forego these professional services.

services. Under some circumstances, the business sale may itself be put at risk of a buyer's later lawsuit seeking to rescind and unwind the transaction because the seller used an unregistered business broker.

A proposal to appropriately scale 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 [to the SEC] on Smaller Public Companies (2006), made the same recommendation (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/2009qforum/abareport062005.pdf). Since 2006, the Alliance of Mergers & Acquisition Advisors (AM&AA), the International Business Brokers Association, the M&A Source, The Business Intermediary Education Foundation (BIEF) and 16 other national and regional professional associations, has been cooperatively working with the SEC staff and state securities regulators to formulate a solution through rulemaking, but in more than eight years the SEC has not made this small business issue a rulemaking priority. HR 477 provides a cost effective, right-sized, regulatory regimen which facilitates the liquidity and continuity of smaller, privately held businesses, preserving and creating jobs throughout the U.S.

Urgent Need for Legislative Action

HR 477 would reduce regulatory costs and burdens on private business sales advised by M&A brokers. Copies of the bill(s), written testimony, and extensive background information are all available upon request.

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