NOTICE OF REQUEST FOR COMMENT REGARDING A PROPOSED NASAA MODEL RULE EXEMPTING CERTAIN MERGER AND ACQUISITION BROKERS FROM REGISTRATION PURSUANT TO STATE SECURITIES ACTS

NASAA Model Rule Exempting Certain Merger and Acquisition Brokers from State Registration[1]

January 2015

The Broker-Dealer Section of the North American Securities Administrators Association ("NASAA") is requesting comment for a proposed uniform state model rule regarding the exemption of certain merger and acquisition brokers ("Merger and Acquisition Brokers") from registration as "brokers," "dealers," "agents," and/or "broker-dealers" pursuant to state securities laws.

Comments are due by February 16, 2015. To facilitate consideration of comments, please send comments to Bryan Lantagne (bryan.lantagne@state.ma.us), Chair of the Broker-Dealer Section; Carolyn Mendelson (cmendelson@pa.gov), Chair of the Market Regulatory Project Group; and Christopher Staley (cs@nasaa.org) at the NASAA Corporate Office.

We encourage, but do not require, comments to be submitted by e-mail. Hard copy comments may be submitted at the address below.

NASAA Legal Department
Chris Staley, Counsel
NASAA
750 First Street, NE, Suite 1140
Washington, DC 20002

Background

On January 31, 2014 (as revised on February 4, 2014), the Staff of the United States Securities and Exchange Commission ("SEC") issued a No-Action Letter to Faith Colish, Esq., Martin A. Hewitt, Esq., Eden L. Rohrer, Esq., Linda Lerner, Esq., Ethan L. Silver, Esq., and Stacy E. Nathanson, Esq. ("SEC Letter"). The SEC Letter states that SEC Staff would recommend that no enforcement action be taken against Merger and Acquisition Brokers who comply with the conditions enumerated in the SEC Letter and do not register as "broker-dealers" with the SEC pursuant to Section 15(b) of the 1934 Securities Act.

In addition to the SEC Letter, prior to 2015, federal legislation has been drafted and/or introduced for consideration by Congress that would exempt Merger and Acquisition Brokers from some of the registration requirements in the federal securities laws. These bills have been

[1] With respect to securities professionals and the firms with which they are associated, some states use the term "licensing" in the same manner other jurisdictions may use the term "registration." While this Rule only refers to "registration," for purposes of this Rule, the two terms should be considered synonymous.

slightly broader in the content and relief granted to Merger and Acquisition Brokers than the SEC Letter.

State securities regulators (the "States") also may decide to exempt Merger and Acquisition Brokers from "broker," "dealer," "broker-dealer," and/or "agent" registration at the state level[2] for those Merger and Acquisition Brokers who qualify for relief from securities registration pursuant to the SEC Letter or as contemplated by federal legislation. [3]

Text of Model Rule

Rule _____. Registration exemption for Merger and Acquisition Brokers

(A) IN GENERAL - Except as provided in paragraphs (B) and (D), a Merger and Acquisition Broker shall be exempt from registration pursuant to _____ under this section.

(B) EXCLUDED ACTIVITIES – A Merger and Acquisition Broker is not exempt from registration under this paragraph if such broker does any of the following:

(i) Directly or indirectly, in connection with the transfer of ownership of an eligible privately held company, receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties to the transaction.

(ii) Engages 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 United States Securities and Exchange Commission under Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b) or with respect to which the issuer files, or is required to file, periodic information, documents, and reports under the Securities Exchange Act of 1934 Section 15(b) subsection (d), 15 U.S.C. 78o(d).

(iii) Engages on behalf of any party in a transaction involving a public shell company.

(C) DISQUALIFICATIONS – A Merger and Acquisition Broker is not exempt from registration under this paragraph if such broker is subject to –

[2] However, certain states do require registration of business brokers at this time. The terms "broker," "dealer," "broker-dealer," "agent" are defined terms in state securities laws.

[3] This model rule only exempts Merger and Acquisition Brokers from the registration provisions of state securities laws and not from any other provisions, including the anti-fraud provisions of state securities laws.

(i) Suspension or revocation of registration under Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b)(4);

(ii) A statutory disqualification described in section 3(a)(39) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(39);

(iii) A disqualification under the rules adopted by the United States Securities and Exchange Commission under Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 77d note); or

(iv) A final order described in paragraph (4)(H) of Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b)(4)(H).

(D) RULE OF CONSTRUCTION – Nothing in this paragraph shall be construed to limit any other authority of this _____ (Commission, Agency) to exempt any person, or any class of persons, from any provision of this title, or from any provision of any rule or regulation thereunder.

(E) DEFINITIONS – In this paragraph:

(i) CONTROL – The term "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 –

(I) is a director, general partner, member or manager of a limited liability company, or officer exercising executive responsibility (or has similar status or functions);

(II) 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

(III) 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.

(ii) ELIGIBLE PRIVATELY HELD COMPANY –

(1) IN GENERAL – The term "eligible privately held company" means a company meeting both of the following conditions:

(aa) The company does not have any class of securities registered, or required to be registered, with the United States Securities and Exchange Commission under Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. 78o(b), or with respect to which the company files, or is required to file, periodic information, documents, and reports under subsection (d), 15 U.S.C. 78o(d).

(bb) In the fiscal year ending immediately before the fiscal year in which the services of the Merger and Acquisition Broker are initially engaged with respect to the securities transaction, the company meets either or both of the following conditions (determined in accordance with the historical financial accounting records of the company):

(AA) The earnings of the company before interest, taxes, depreciation, and amortization are less than $25,000,000.

(BB) The gross revenues of the company are less than $250,000,000.

(iii) Merger and Acquisition Broker – The term "Merger and Acquisition Broker" means any broker and any person associated with a broker engaged in the business of effecting securities transactions solely in connection with the transfer of ownership of an eligible privately held company, regardless of whether that broker acts on behalf of a seller or buyer, through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of the eligible privately held company, if the broker reasonably believes that –

(I) upon consummation of the transaction, any person acquiring securities or assets of the eligible privately held company, acting alone or in concert, will control and, directly or indirectly, will be active in the management of the eligible privately held company or the business conducted with the assets of the eligible privately held company; and

(II) if any person is offered securities in exchange for securities or assets of the eligible privately held company, such person will, prior to becoming legally bound to consummate the transaction, receive or have reasonable access to the most recent fiscal year-end financial statements of the issuer of the securities as customarily prepared by its management in the normal course of operations and, if the financial statements of the issuer are audited, reviewed, or compiled, any related statement by the independent accountant; a balance sheet dated not more than 120 days before the date of the exchange offer; and information pertaining to the management, business, results of operations for the period covered by the foregoing financial statements, and any material loss contingencies of the issuer.

(iv) PUBLIC SHELL COMPANY – The term "public shell company" is a company that at the time of a transaction with an eligible privately held company –

(1) has any class of securities registered, or required to be registered, with the United States Securities and Exchange Commission under Section 12, 15 U.S.C. 78o(b), or with respect to which the company files, or is required to file, periodic information, documents, and reports under subsection (d), 15 U.S.C. 78o(d); and

(2) has no or nominal operations; and

(3) has –

(aa) no or nominal assets;

(bb) assets consisting solely of cash and cash equivalents; or

(cc) assets consisting of any amount of cash and cash equivalents and nominal other assets.

(F) INFLATION ADJUSTMENT

(i) IN GENERAL – On the date that is five years after the date of the enactment of the rule, and every five years thereafter, each dollar amount in subparagraph (D)(ii)(II) shall be adjusted by –

(1) dividing the annual value of the Employment Cost Index For Wages and Salaries, Private Industry Workers (or any successor index), as published by the Bureau of Labor Statistics, for the calendar year preceding the calendar year in which the adjustment is being made by the annual value of such index (or successor) for the calendar year ending December 31, 2012; and

(11) multiplying such dollar amount by the quotient obtained under sub clause (1).

(ii) ROUNDING – Each dollar amount determined under clause (i) shall be rounded to the nearest multiple of $100,000.

Request for Comments

In particular, the Broker-Dealer Section is interested in receiving comments regarding:

1. Should the proposed model rule specifically include how long the buyer(s) must control and actively operate the acquired company in the M&A Transaction?
2. Should the proposed model rule specifically address and disallow fee splitting between a Merger and Acquisition Broker and a party which is not a registered broker, dealer, broker-dealer, or agent and which also does not qualify for registration exemption as a Merger and Acquisition Broker?
3. Should the exemption for the Merger and Acquisition Broker in the proposed model rule be restricted as to the size of the M&A Transaction?
4. Should the parameters and definition of an "eligible privately held company" be adjusted, particularly as it pertains to company earnings and revenues?
5. Identification by commenters of the differences between this model rule and the SEC Letter, as previously defined and the implications of the differences.
6. Should a private equity firm or a private fund be permitted to be defined as a Merger and Acquisition Broker pursuant to the proposed model rule? If so, under what circumstances? More specifically, should a private equity firm or a private fund that provides investment banking services, related to mergers and acquisitions, to companies in its portfolio be permitted to be defined as a Merger and Acquisition Broker pursuant to the proposed model rule?