HOUSE OF REPRESENTATIVES
FINAL BILL ANALYSIS

BILL #:	CS/CS/HB 817	**FINAL HOUSE FLOOR ACTION:**	
SPONSOR(S):	Regulatory Affairs Committee; Insurance & Banking Subcommittee; Raulerson	117 **Y's**	0 **N's**
COMPANION BILLS:	CS/CS/SB 286	**GOVERNOR'S ACTION:**	Approved

SUMMARY ANALYSIS

CS/CS/HB 817 passed the House on March 4, 2016, as CS/CS/SB 286.

A sale of a privately held company can be structured as an asset sale or a stock sale, depending on the needs and circumstances of the buyer and seller. Generally, an *asset sale* is the sale of individual assets and liabilities, such as equipment, fixtures, leaseholds, goodwill, trade secrets, and inventory, without a transfer of title or ownership of the business. On the other hand, a buyer acquires ownership in the business in a *stock sale* through a purchase of shareholders' stock. Due to complex taxation, liability, and operational considerations involved in asset or stock sales, buyers and sellers often utilize the services of "merger and acquisition brokers" (M&A brokers), in addition to professional services by attorneys and accountants, to assist in the valuation, contract negotiation, and transitional aspects of a sale.

While the sale of a company's *assets* is not a securities transaction, a sale or exchange of a company's *stock* is a securities transaction, and thus triggers the application of state and federal securities laws, requiring registration of both the securities and the broker-dealer with the U.S. Securities & Exchange Commission (SEC) and the state securities regulator, unless applicable exemptions are available. In Florida, the securities regulator is the Office of Financial Regulation (OFR), which enforces the Florida Securities and Investor Protection Act (ch. 517, F.S., "the Act"). Currently, M&A brokers engaging in stock sales must be registered at both state and federal levels as a broker-dealer. Registration of M&A securities and M&A brokers and ongoing regulatory compliance can entail significant costs that are passed onto the buyers and sellers of privately held companies. In response to industry efforts to enhance small business capital formation and to reduce regulatory burdens, the SEC and a national securities regulator association have recently developed guidelines and criteria for exempting the M&A broker from federal and state broker-dealer registration.

The bill amends the Act to create state-level transactional and broker exemptions for securities transactions conducted by an M&A broker. If certain conditions are met, brokers operating exclusively as M&A brokers utilizing the M&A transactional exemption will not have to register with the OFR. The bill also defines "control person," "eligible privately held company," "merger and acquisition broker," "public shell company," and sets forth grounds disqualifying an M&A broker from the broker exemption.

The bill has an insignificant negative fiscal impact on the General Revenue Fund due to the elimination of M&A broker registration fees. The OFR estimates that ten currently registered M&A brokers will meet the exemption requirements of the bill, representing a loss of approximately $2,000 in revenue that would be deposited into the General Revenue Fund. The bill does not have a fiscal impact on local government. The bill may have a positive impact on the private sector by reducing regulatory burdens and costs on M&A brokers and the buyers and sellers of eligible privately held companies who use the services of M&A brokers.

The bill was approved by the Governor on March 25, 2016, ch. 2016-111, L.O.F., and will become effective on July 1, 2016.

I. SUBSTANTIVE INFORMATION

A. EFFECT OF CHANGES:

Current Situation

Merger & Acquisition Brokers

When a privately held business is sold, the sale can be structured as either an asset sale or a stock sale, depending on the parties' negotiated agreement. Generally, an *asset sale* is the sale of individual assets and liabilities, such as equipment, fixtures, leaseholds, goodwill, trade secrets, and inventory, without a transfer of title or ownership of the business. On the other hand, a buyer acquires ownership in the business in a *stock sale* through a purchase of shareholders' stock. Generally, buyers prefer asset sales and sellers prefer stock sales, for a number of taxation and liability reasons.[1]

Because taxation and liability are primary considerations in the sale and purchase of privately held businesses, both owners and prospective buyers of small-cap and mid-cap companies often seek, in addition to legal and accounting advice, the assistance of professional business brokerage advice from "merger and acquisition brokers" (M&A brokers). Such business brokerage services may include:

- Business valuation and financial modeling;
- Soliciting or marketing, locating, and screening potential buyers and sellers;
- Advising a buyer or seller with contract negotiation and execution;
- Due diligence; and
- Assistance with transitional changes in ownership and control, such as human resources and intellectual property.

While the sale of a company's *assets* is not a securities transaction, a sale or exchange of a company's *stock* for compensation is a securities transaction[2] and thus triggers the application of state and federal securities law, requiring registration of both the securities and the M&A broker with the U.S. Securities & Exchange Commission (SEC) and applicable state securities regulators, unless an applicable exemption is available. As discussed in further detail below, state and federal securities laws and regulations are designed to govern the offer, sale, distribution, and trading of securities and to regulate the market participants in those transactions in order to protect the investing public. While some exemptions currently exist to provide regulatory relief to smaller businesses, none specifically exempt M&A brokers serving smaller businesses and thus require them to register, regardless of the size, scope, or frequency of their business brokerage activities.

According to the bill's proponents, initial costs of broker registration and ongoing compliance can be significant – an estimated $150,000 initially and more than $75,000 annually. These regulatory costs are passed on to the small business buyers and sellers who use the services of an M&A broker.[3] In 2005, an American Bar Association task force on private placement broker-dealers issued a report noting that the regulatory model was lengthy, costly, and not "right-sized" for M&A brokers who only effect several M&A transactions a year and otherwise do not hold customer funds or securities.[4]

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[1] ALLIED BUSINESS GROUP, *Asset Sale vs. Stock Sale: What's the Difference?*, at http://www.alliedbizgroup.com/resources/publications/asset-sale-vs-stock-sale.html (last visited Dec. 18, 2015).

[2] Both federal and Florida securities law broadly define "security" to include, among other things: notes; stocks; bonds; debentures; certificates of deposit; evidence of indebtedness; and investment contracts. 15 U.S.C. § 77b(a)(1) and s. 517.021(22), F.S.

[3] ALLIANCE OF MERGER & ACQUISITION ADVISORS AND INTERNATIONAL BUSINESS BROKERS ASSOCIATION, *S. 1923 and H.R. 2274: Highlights and History* (Aug. 20, 2014), on file with the Insurance & Banking Subcommittee staff.

[4] AMERICAN BAR ASSOCIATION, *Report and Recommendation of the Task Force on Private Placement Broker-Dealers* (Jun. 20, 2005), at: http://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf.

Federal Securities Regulation

The federal Securities Act of 1933 ('33 Act) requires every offer or sale of securities using the means and instrumentalities of interstate commerce to be registered with the U.S. Securities & Exchange Commission (SEC), unless an exemption is available.[5] The '33 Act's emphasis on disclosure of important financial information through the registration of securities enables investors to make informed judgments about whether to purchase a company's securities. While the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have important recovery rights if they can prove that there was incomplete or inaccurate disclosure of important information.[6] Once a company is registered under the '33 Act or becomes publicly traded, it becomes subject to periodic reporting requirements under the federal Securities Exchange Act of 1934 ('34 Act), which also requires registration of market participants like broker-dealers and exchanges.[7]

Generally, any person acting as "broker" or "dealer" as defined in the '34 Act must be registered with the SEC and join a self-regulatory organization (SRO), the Financial Industry Regulatory Authority (FINRA), a national securities exchange, or both. The '34 Act broadly defines "broker" as "any person engaged in the business of effecting transactions in securities for the account of others," which the SEC has interpreted to include involvement in any of the key aspects of a securities transaction, including solicitation, negotiation, and execution.[8] In addition, broker-dealers must also comply with state registration requirements.

Federal Regulatory Policy on M&A Brokers

In 2014, the SEC issued a no-action letter that defined "M&A brokers" and outlined the activities that could be conducted and transactions that could be effected without requiring federal registration with the SEC. The SEC opined that it would not require M&A brokers to be registered as broker-dealers with the SEC when the M&A broker was a broker "…engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of a privately-held company through the purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving securities or assets of the company to a buyer that will actively operate the company or the business conducted with the assets of the company." Prior to the release of this no-action letter, it was unclear when an M&A broker had to be registered with the SEC, often resulting in some sectors engaging in unregistered activity.[9]

The SEC no-action letter applies only to federal registration requirements of the '34 Act. Other provisions of the federal securities laws, including the anti-fraud provisions, continue to apply to these transactions.[10] In addition, bills have been introduced in Congress in recent years to exempt certain M&A brokers from federal registration requirements, although none have passed both houses.[11]

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[5] 15 U.S.C. §§ 77a-77aa.
[6] U.S. SECURITIES AND EXCHANGE COMMISSION, *The Laws That Govern the Securities Industry*, http://www.sec.gov/about/laws.shtml (last visited Jan. 19, 2016).
[7] *Id.*
[8] 15 U.S.C. §§ 78c(4) and 78o. U.S. SECURITIES AND EXCHANGE COMMISSION, *Guide to Broker-Dealer Registration*, http://www.sec.gov/divisions/marketreg/bdguide.htm#II (last visited Jan. 19, 2016).
[9] U.S. SECURITIES AND EXCHANGE COMMISSION, *No-Action Letter Re: M&A Brokers* (Jan. 31, 2014; revised Feb. 4, 2014), http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf. The request for the SEC no-action letter cited the 2005 ABA task force report (see footnote 4, *supra*) , which discussed the "gray market" and potential liability for violations of securities laws for individuals who raise funds for small businesses or engage in M&A activities on a commission basis.
[10] A SEC no-action letter only expresses the SEC staff's enforcement position on a requesting individual or entity's particular facts and circumstances. It does not have the force of law or adopted regulations. *See* U.S. SECURITIES AND EXCHANGE COMMISSION, *No-Action Letters*, at http://www.sec.gov/answers/noaction.htm (last visited Jan. 19, 2016).
[11] Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act, H.R. 686 and S. 1010, 114th Cong. (2015) and H.R. 2274 and S. 1923, 113th Cong. (2014). These and similar bills apply only to federal registration and would not preempt state registration laws.

State Securities Regulation

In addition to federal securities laws, "Blue Sky Laws" are state laws that protect the investing public through registration requirements for both broker-dealers and securities offerings, merit review of offerings, and various investor remedies for fraudulent sales practices and activities.[12] In Florida, the Securities and Investor Protection Act, ch. 517, F.S. (the Act), regulates securities issued, offered, and sold in the state of Florida. The Florida Office of Financial Regulation (the OFR)'s Division of Securities regulates and registers the offer and sale of securities in, to, or from Florida by firms, branch offices, and individuals affiliated with these firms in accordance with the Act and ch. 69W, Florida Administrative Code.[13]

As mentioned above, brokers engaged in interstate commerce must be federally registered and must also register with the state as a "dealer" in which the dealer has an office or engages in business with the state.[14] The Act prohibits dealers, associated persons, and issuers from offering or selling securities in this state unless registered with the OFR as a broker, or they are specifically exempted.[15] State dealer registration requires completion of a registration form, submission of fingerprints for state and federal criminal background checks, minimum net capital requirements, payment of registration fees, and a review by the OFR to determine the applicant's fitness for registration in accordance with the Act.[16] All dealer registration fees become revenue of the state, except for that portion of the registration fees that are assessments for purposes of the Securities Guaranty Fund.[17]

Additionally, all *securities* in Florida must be registered with the OFR unless they meet one of the transactional exemptions in s. 517.051, F.S., or s. 517.061, F.S., or are federally covered (i.e., under the exclusive jurisdiction of the SEC).[18] It is important to note that exempt securities are still subject to the Act's anti-fraud and boiler room provisions.[19]

Currently, the Act contains two transactional exemptions for certain merger transactions:

- Mergers where two corporations have $500,000 or more in assets and where the sale price is $50,000 or more, are transactions that qualify for a securities registration exemption under s. 517.061(8), F.S.
- Similarly, mergers approved by the vote of the security holders are transactions that qualify for a securities registration exemption under s. 517.061(9), F.S.

Dealers who facilitate transactions through one of these two exemptions are currently exempt from registration pursuant to s. 517.12(3), F.S. Failure to meet the precise requirements of these exemptions, can subject the issuer to civil, criminal, and administrative liability for the sale of unregistered securities, which is a third-degree felony in Florida.[20] Civil remedies under the act include rescission and damages.[21] In addition, issuers must comply with disclosure requirements in state and federal laws that provide potential investors with full and fair disclosures regarding the security. However, there is no blanket M&A *broker or dealer* exemption in the Act.

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[12] U.S. SECURITIES AND EXCHANGE COMMISSION, *Blue Sky Laws*, http://www.sec.gov/answers/bluesky.htm (last visited Dec. 18, 2015).
[13] Pursuant to s. 20.121(3)(a), F.S., the Financial Services Commission (the Governor and Cabinet) serves as the OFR's agency head for purposes of rulemaking and appoints the OFR's Commissioner, who serves as the agency head for purposes of final agency action for all areas within the OFR's regulatory authority.
[14] s. 517.021(6), F.S. (definition of "dealer").
[15] s. 517.12, F.S.
[16] *Id.* and s. 517.161, F.S.
[17] ss. 517.12(10) and 517.131(1), F.S.
[18] s. 517.07, F.S. If a security is registered with the SEC, s. 517.082, F.S., requires the broker or issuer to notify OFR that the security is federally registered.
[19] s. 517.061; *see* ss. 517.301, 517.311, and 517.312, F.S.
[20] s. 517.302(1), F.S.
[21] s. 517.211(3)-(5), F.S.

State Securities Regulators' Model Rule - M&A Broker Exemption

Since at least 2012, California, South Dakota, Texas, and Utah have adopted limited broker-dealer or transactional exemptions for M&A transactions.[22] In September 2015, the North American Securities Administrators Association (NASAA), adopted a model rule, which provides a uniform approach to state-level securities regulation and provides an exemption for M&A brokers if certain conditions are met.[23]

Effect of the Bill

The bill provides a transactional exemption for the offer or sale of securities of an eligible privately held company through a registered dealer or through an M&A broker, if certain conditions are met. The bill also exempts the M&A broker from registration with the OFR if certain conditions are met.

The bill provides that an *M&A broker* is any broker (defined as meaning the same as "dealer" in the Act) and any person associated with a broker engaged in the business of effectuating 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. Further, the bill provides that the broker must receive written assurances from the control person with the largest percentage of ownership (for both the buyer and seller) that:

- After completion of the transaction, any person who acquires securities or assets of the eligible privately held company will be a control person of that company or for the business conducted with the eligible privately held company's assets.
    - The bill defines the term "*control person*" as an individual or certain entity that possesses the power to direct the management or policies of a company through ownership of securities, by contract, or otherwise. The bill also lists grounds for presuming control.
- Any person that is offered securities in exchange for the eligible privately held company's securities or assets will receive financial statements of the issuer of the securities offered in the exchange, prior to becoming legally bound to complete the transaction.

An *eligible privately held company* means a company that meets the following requirements:

- The company does not have any class of securities which is registered or required to be registered with the SEC or the OFR, or for which the company is required to report with the SEC; and
- In the fiscal year immediately preceding the fiscal year during which the M&A broker begins to provide services for the securities transaction, the company has earnings before interest, taxes, depreciation, and amortization (EBITDA) of less than $25 million or has gross revenues of less than $250 million. On July 1, 2021, and every 5 years thereafter, each dollar amount shall be adjusted for inflation through certain calculations.

To provide protections for buyers and sellers, the bill provides several grounds for disqualifying M&A brokers from the exemption (and thus requiring registration) if he or she:

- Receives, holds, transmits, or has custody of the funds or securities to be exchanged by the parties.

[22] On file with the Insurance & Banking Subcommittee staff.

[23] The NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities regulators/administrators in the 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and Mexico. The NASAA's Model Rule, *Exempting Certain Merger & Acquisition Brokers from Registration*, was adopted Sept. 29, 2015: http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/MA-Broker-Model-Rule-adopted-Sept.-29-2015.pdf.

- Engages on behalf of an issuer in a public offering of securities which are required to be registered with the SEC or the OFR, or for which the issuer is required to file certain documents pursuant to 15 U.S.C. s. 78o(d).
- Engages on behalf of any party in a transaction involving a *public shell company*, which the bill defines as a company (that at the time of a transaction with an eligible privately held company) that:
    - Holds federally or state registered securities, or is required to file or report to the SEC under 15 U.S.C. s. 78o(d);
    - Has nominal or no operations; and
    - Has nominal or no assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amounts of cash and cash equivalents and nominal other assets.
- Is subject to certain federal securities administrative actions:
    - Suspension or revocation of registration or being the subject to a final order under the '34 Act [15 U.S.C. § 78o(b)(4) and (b)(4)(H)];
    - Statutory disqualification with respect to membership, participation, or association with a SRO, under the '34 Act [15 U.S.C. § 78c(a)(39)]; or
    - Felony and "bad boy" disqualifications under 17 C.F.R. § 230.506.

As with other exemptions in the Act, the bill's exemption does not preclude the OFR from investigating and prosecuting cases involving fraud, false representations, and other prohibited practices in ss. 517.301, 517.311, and 517.312, F.S. However, because the M&A exemption covers a business transaction (i.e., the offer or sale of securities of privately held companies rather than the offer or sale of securities to the general public), the OFR has indicated that the covered transaction does not implicate significant investor protection concerns.[24]

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   The bill has an insignificant fiscal impact on revenues deposited into the General Revenue Fund. According to the OFR, approximately ten M&A brokers are currently registered as a securities dealer. Exempting these M&A brokers from the $200 registration fee will result in approximately $2,000 in lost revenue to the General Revenue Fund.[25]

2. Expenditures:

   According to the OFR, the bill has an indeterminate impact on state government expenditures. However, the OFR indicates that any expenditure caused by the effects of the bill can be absorbed within existing resources.[26]

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

[24] Office of Financial Regulation, Agency Analysis of 2016 House Bill 817, pp. 2-3 (Dec. 29, 2015).
[25] Email correspondence with the Office of Financial Regulation (Jan. 19, 2016) on file with the Government Operations Appropriations Subcommittee.
[26] *Id.*

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may have a positive impact on the private sector by reducing regulatory burdens and costs on M&A brokers, as well as on the buyers and sellers of privately held eligible companies who use the services of M&A brokers in Florida.

D. FISCAL COMMENTS:

None.