Murders & Executions: The SEC's Regrettable Reluctance to Formalize a Finder's Exemption in M&A Transactions*

INTRODUCTION

> I am an intermediary in corporate mergers and acquisitions. I am a one man operation, with my office in my home. I have absolutely nothing to do with the retail or wholesale securities business . . . .
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> . . . .
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> The ultimate problem is that the SEC, in designating me a broker-dealer, is attempting to bring me under a body of rules and regulations designed for an entirely different type of business than I am in. It is obvious that this will result in nothing but continuing asininity, and occasional out right illegality . . . .[1]

"Mergers and acquisitions" is an often misunderstood and perhaps intimidating field encompassing both complex transactional law issues, as well as specialized business practices. Since the decade of the 1980s[2] and the birth of the hostile takeover, business combinations have become more frequent and involve increasingly large capital expenditures.[3] So numerous have mergers and acquisition transactions become, popular culture has embraced their drama in both film[4] and novel.[5] While the volume of mergers and acquisitions is increasing at a rapid pace, the Securities and Exchange Commission has lagged behind, failing to put in place proper regulatory reform that would provide freedom for small businesses[6] to capitalize upon business combinations.

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1. Henry C. Goppelt, SEC No-Action Letter, 1974 WL 10669, at *1–2 (June 2, 1974).

2. JOHN DOBSON, BULLS, BEARS, BOOM, AND BUST: A HISTORICAL ENCYCLOPEDIA OF AMERICAN BUSINESS CONCEPTS 346 (2007).

3. *See* Joseph H. Flom, *Mergers & Acquisitions: The Decade in Review*, 54 U. MIAMI L. REV. 753, 753–55 (2000) (showing an increase in business combinations from an average of less than 1,000 deals announced per year during the 1970s to more than 9,000 in 1999).

4. *See, e.g.*, AMERICAN PSYCHO (Lions Gate Entertainment 2000).

5. *See, e.g.*, BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1990); BRET EASTON ELLIS, AMERICAN PSYCHO (1991).

6. For purposes of this piece, "small business" is defined as any company with a market capitalization of less than $5,000,000. The central role small businesses and start-ups play in the American economy should not be underestimated. In 2008, near the height

While investment bankers, registered as broker-dealers under the Securities Exchange Act of 1934,[7] are often used by larger corporations seeking to coordinate a business combination, smaller businesses often "fly below the radar."[8] Smaller corporations planning to purchase a business typically use informal channels to find companies interested in selling.[9] These avenues often include meetings between senior management, attorneys, financial advisers, and third party consultants, or "finders."[10]

A particular subset of these "finders" is made up of "business brokers," who "attempt to initiate or arrange transactions between potential buyers and sellers of a business."[11] The SEC has implicitly recognized that some business broker activities fall outside of the intent and purpose of the '34 Act, and thus a de facto exemption

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of the global financial crisis, an average of 320 out of every 100,000 adults launched a company every month. ROBERT W. FAIRLIE, KAUFFMAN INDEX OF ENTREPRENEURIAL ACTIVITY, 1996–2008, at 4 (2009), http://www.kauffman.org/uploadedFiles/kiea_042709.pdf.

7. 15 U.S.C. §§ 78a–78nn (2006). An investment bank can provide a number of services that will require the firm's registration under the '34 Act, including the underwriting of securities, the placement of securities with dealers, and the structuring and negotiation of merger agreements. *See* THE DEALMAKER'S DICTIONARY OF MERGER AND ACQUISITION TERMINOLOGY 109–10 (Donnan Mandell ed., 1984).

8. *See* Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *Report and Recommendations of the Task Force on Private Placement Broker-Dealers*, 60 BUS. LAW. 959, 960 (2005) (explaining that small businesses seeking less than $5 million are "almost never interesting to professional capital"). Mergers between companies with small market capitalizations are rarely capable of attracting the attention of established investment banks or, if such interest does exist, of affording the often times significant commissions demanded by such intermediaries. *See* GERALD A. BENJAMIN & JOEL MARGULIS, THE ANGEL INVESTOR'S HANDBOOK: HOW TO PROFIT FROM EARLY-STAGE INVESTING 14–16 (2001) (describing the mounting costs associated with counsel and investment banking services as restricting start-up companies). *See generally* Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *supra*, at 960 ("The activities of [Private Placement Broker-Dealers] is [sic] of critical importance to the efforts of a vast number of small businesses, and without their assistance it is unlikely that a great percentage of such businesses would ever be successful in raising early stage funding."). *But see generally* Henri Servaes & Marc Zenner, *The Role of Investment Banks in Acquisitions*, 9 REV. FIN. STUD. 787, 787 (1996) (explaining that transaction costs, information asymmetries, deal complexity, and a target's ownership structure were the significant determining factors in whether an acquirer would use an investment bank to broker a deal).

9. Tal Tirosh, *Initial Discussions & Strategic Considerations*, *in* M & A PRACTICE GUIDE § 4.03(1) (Stephen I. Glover et al. eds., 2010).

10. *Id.*

11. Kevin A. Zambrowicz & Michael J. Burbach, *SEC Staff No-Action Letter Regarding Business Brokers: Anomaly or Shift in SEC Approach?*, BANKING & FIN. SERVICES POL'Y REP., January 2007, at 3, 4 ("Business brokers are essentially a subset of finders."). Throughout this piece, "finder" and "business broker" are used interchangeably.

currently exists.[12] Given a niche, these business brokers could provide critical merger assistance to those small businesses that lack the resources necessary to attract and retain an investment bank.

This piece begins with an analysis of the SEC no-action letters addressing business brokers in the context of mergers and acquisitions. Drawing upon the acknowledged differences between finders and broker-dealers, it then puts forth a proposal for a formal exemption to broker-dealer registration under the '34 Act.

I. SEC ANALYSIS OF BROKER-DEALER REGISTRATION[13]

Perhaps recognizing the confusion that surrounds broker-dealer registration, the SEC published a guide to help an individual decide if she is "engaged in the business of effecting transactions in securities for the account of others."[14] The guide references "finders" or "business brokers" and poses four questions, which paired with previous no-action letters, provide insight into the thought process of the SEC.[15] The first question the SEC asks is whether the business broker participates in "important parts of a securities transaction including solicitation, negotiation, or execution of the transaction."[16] The second focuses on the *form of compensation* received by the business broker.[17] The SEC's third question asks whether the finder is "otherwise engaged in the business of effecting or facilitating

12. *See id.* ("[T]he SEC staff has determined that a business broker may engage in . . . limited activities at the initial stages of a proposed transaction without generally having to register as a broker under the Exchange Act."). In particular, the SEC has relied upon two "no-action" letters to describe what business a finder may conduct without becoming responsible for registration as a broker-dealer. *See* Country Bus., Inc., SEC No-Action Letter, 2006 WL 3289777 (Nov. 8, 2006); Int'l Bus. Exch. Corp., SEC No-Action Letter, 1986 WL 67535 (Dec. 12, 1986).

13. The primary source of guidance when determining whether an individual must be registered under the '34 Act is the collection of "no-action" letters issued by the SEC staff. No-action letters are requests by private citizens or businesses that the SEC take "no action" adverse to its plans, as stated in the initial request. SEC CONSEQUENCES OF CORPORATE ACQUISITIONS 221 (Carl W. Schneider ed., 1971) (stating that a no-action letter is "the most common form of interpretive 'ruling' which emanates from the Commission"). These no-action letters are fact-intensive and "are staff interpretations rather than formal Commission action and thus have extremely limited, if any, precedential weight." 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1.4[4], at 48 (5th ed. 2005).

14. DIV. OF TRADING & MKTS, U.S. SEC. & EXCH. COMM'N, GUIDE TO BROKER-DEALER REGISTRATION, at pt. II.A. (2008), http://www.sec.gov/divisions/marketreg/bdguide.htm.

15. *Id.*

16. *Id.*

17. *Id.*

securities transactions."[18] Lastly, the SEC asks if the finder holds funds or securities on behalf of a client.[19] There have been a handful of no-action letters regarding the activities of business brokers, and before turning to a formal exemption proposal, the SEC's application of these factors must be reviewed in more detail.

A. SEC Determination of Finder vs. Broker-Dealer[20]

The story begins in 1972 with a no-action request on behalf of Corporate Forum, Inc.[21] Corporate Forum was to actively seek merger and acquisition candidates as well as conduct financial analyses, if requested by the client.[22] In response, the SEC stated that it "would not raise any question if the Corporation does not register as a broker-dealer."[23] In its appraisal of Corporate Forum's request, he SEC staff found it particularly important that Corporate Forum refrain from participating in negotiations between its client and merger candidates.[24]

In a no-action letter drafted at nearly the same time as the Corporate Forum letter, the SEC informed Fulham & Co. that it *would* pursue action if Fulham failed to register as a broker-dealer.[25] As opposed to Corporate Forum, Fulham was to act as a private investment bank for companies that sought to raise venture capital and other alternative financing.[26] The SEC staff ultimately denied Fulham's request for no-action, expressing at an early stage its discomfort with a finder's direct participation in the negotiations between two parties.[27]

The SEC further stressed the "negotiations" factor in its no-action recommendation for Russell R. Miller Corporation.[28]

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18. *Id.*
19. *Id.*
20. For a more detailed and comprehensive discussion of broker-dealer registration, see generally David A. Lipton, *A Primer on Broker-Dealer Registration*, 36 CATH. U. L. REV. 899 (1987).
21. Corporate Forum, Inc., SEC No-Action Letter, 1972 WL 9128, at *1 (Dec. 10, 1972).
22. *Id.*
23. *Id.* at *2.
24. *Id.*
25. Fulham & Co., Inc., SEC No-Action Letter, 1972 WL 9129, at *2 (Dec. 20, 1972).
26. *Id.* at *1.
27. *Id.* at *2.
28. *See* Russell R. Miller & Co., Inc., SEC No-Action Letter, 1977 WL 10938 (Aug. 15, 1977). As a finder for buyers or sellers, Miller proposed to use its industry expertise to value potential targets. *Id.* at *1–2. It was not, however, to play any role in negotiating the terms or price of the deal. *Id.* at *1.

Interestingly, despite its distaste for transaction-based compensation, the SEC allowed Miller to receive a finder's fee based on a "declining percentage of the consideration paid or received for the sale or purchase."[29] The SEC recognized that Miller "is retained to bring to bear its knowledge and expertise . . . to the task of identifying an acquisition prospect."[30] Thus despite proposing to receive transaction-based compensation, Miller was seemingly able to avoid broker-dealer registration by refraining from participation in negotiations between the two parties. The SEC's no-action letter to Russell R. Miller would be the last significant development in the field for nearly a decade.

B. The Modern Approach

In what is widely considered the landmark business broker no-action letter, the SEC granted the no-action request of International Business Exchange Corporation ("IBEC").[31] IBEC was a true business broker whose purpose was to advertise and sell closely-held corporations, proprietorships, and partnerships.[32] Its role would be limited to the transmission of documents between the two parties.[33] Of particular significance to the SEC, IBEC was not to advise either of the parties involved as to what form of consideration should be used to effect the transaction.[34] In exchange for its services, IBEC was to receive a commission based upon the selling price.[35] Significantly, the compensation would be paid in cash and would be set *before* the parties determined the form of consideration for the combination itself.[36] In response, the SEC provided its strongest language, to date, in support of a de facto exemption for business brokers:

> This office has traditionally indicated that individuals who do nothing more than bring merger and acquisition-minded persons or entities together and who do not participate in

29. *Id.* at *4. The payment of the commission was conditioned upon the closing of the sale. *Id.* at *2. In granting Miller's no-action request, the SEC noted that Miller was not to participate in any way in negotiations, *id.* at *3, nor was it to allowed to decide whether the consideration for the merger would be in cash or securities, *id.* at *4.

30. *Id.* at *4. It is worth noting that Miller volunteered to register as an investment adviser under the Investment Advisers Act of 1940. *Id.* at *5.

31. Int'l Bus. Exch. Corp., 1986 WL 67535, at *2.

32. *Id.* at *1. In so doing, IBEC was to refrain from participating in negotiations between the parties and, furthermore, was to refuse to value either participant's shares. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.* at *1–2.

> negotiating the sale of securities, nor share in any profits realized, are probably not brokers and would not be required to register as such. In contrast, we have also said that a professional who brings together potential buyers and sellers and advises the parties on questions of value, plays an integral role in negotiating the transaction, or provides other services designed to facilitate the transaction, may be deemed to be a broker.[37]

This statement provides critical insight into the SEC's analysis. First, the SEC focuses the bulk of its attention upon the business broker's role in the merger negotiations, at least when the sale of securities is involved.[38] Second, the SEC adds the caveat that a business broker may not "share in any profits realized" as a result of the sale of securities.[39] This leaves the door open for a business broker to receive transaction-based compensation, so long as the broker is unable to influence whether stock is used as consideration in the deal itself.[40] Third, and less obvious, is the SEC's choice of language between the two clauses. In the first, the SEC is speaking of "individuals" while in the second, the SEC references a "professional."[41] Looking back at the statutory definition of "broker-dealer," this language seems intended to distinguish those who are "engaged in the business" from those who are not.[42] Yet in practice, the SEC ignored this distinction by allowing IBEC, a professional business broker, to avoid broker-dealer registration. While many finders are indeed individuals, the SEC's use of this language while simultaneously rendering a contrary decision indicates that while a business broker's continued involvement in the securities industry may be worth consideration, it is neither dispositive nor of great significance.

It was not until 2006 that the SEC would again thoroughly discuss the activities in which a business broker may engage without registering as a broker-dealer. In addition to the IBEC letter, the no-

37. *Id.* at *2.

38. *See id.*

39. *See id.*

40. *See, e.g.*, *id.* (basing a no-action recommendation in part on the fact that the form of compensation was independent from the conveyance); *see also* Zambrowicz & Burbach, *supra* note 11, at *5 ("[T]he letter appears to recognize that a business broker may receive a transaction-based fee in certain limited situations, but due to the determination of the compensation structure being done prior to the transaction . . . .").

41. *See* Int'l Bus. Exch. Corp., 1986 WL 67535, at *2.

42. A "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others." 15 U.S.C. § 78c(a)(4)(A) (2006).

action response to Country Business, Inc. ("CBI") is exemplary of the SEC's current treatment of business brokers.[43] In a situation nearly identical to that of the IBEC request, CBI sought to provide services "that are more extensive than simply acting as a finder of potential purchasers."[44] CBI was to represent sellers of small, closely held corporations, partnerships, proprietorships, or limited liability corporations.[45] CBI's role in negotiations was limited to transmitting documents between the two parties, valuing the seller's business as an ongoing concern, and assisting the seller with administrative support.[46] Similar to IBEC, CBI was to refrain from advising the parties as to the form of consideration used in consummating the merger.[47] Of note, CBI's compensation was to be determined *before* the structure of the deal was decided and could be a "fixed fee, hourly fee, a commission, or a combination thereof, that is based upon the consideration received by the seller, *regardless* of the means used to effect the transaction."[48]

The SEC, in granting CBI's no-action request, again recognized that a professional organization may, when properly limited, do more than merely introduce two acquisition-minded parties.[49] The critical factors, thus far, seemed to be the broker's limited participation in negotiations, its refusal to advise on deal structure, and its acceptance of compensation that is determined *prior* to the creation of the merger agreement.[50]

In 2007, the SEC shifted its stance in an unwelcomed denial of Hallmark Capital Corporation's no-action request.[51] In its request, Hallmark Capital succinctly described itself as a "financial consultant and finder for small businesses that assists the owners of businesses in raising capital, facilitates mergers and acquisitions and provides

43. *See* Country Bus., Inc., 2006 WL 3289777, at *1.

44. Letter from Craig McCrohon, Counsel for Country Bus., Inc., to Catherine McGuire, Chief Counsel and Assoc. Dir., Div. of Mkt. Regulation, Sec. & Exch. Comm'n 1 (Nov. 8, 2006), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/cbi110806-incoming.pdf.

45. *Id.* at 2.

46. *Id.*

47. Country Bus., Inc., 2006 WL 3289777, at *1.

48. *Id.* (emphasis added). CBI's compensation was not to "vary according to the form of conveyance." *Id.*

49. *See id.*; *see also* Int'l Bus. Exch. Corp., 1986 WL 67535 (granting IBEC's no-action request even though IBEC transmitted documents between the parties in a negotiation).

50. *See* discussion *supra* Part I.B.

51. *See* Hallmark Capital Corp., SEC No-Action Letter, 2007 WL 1879799, at *1 (June 11, 2007).

strategic business consulting services."[52] As a finder, Hallmark Capital was to merely arrange a meeting between the two parties.[53] Any acquisition was to involve only a single buyer and Hallmark Capital expressly disclaimed any participation in the merger negotiations.[54]

What is most frustrating about the denial of Hallmark Capital's request is the SEC's complete refusal to explain its rationale.[55] Rather than going through an analysis—as it had done in previous no-action letters—the staff chose instead to merely reference the CBI letter, its own website, and an article in *The Business Lawyer*.[56]

II. INTERPRETING THE SEC'S CURRENT APPROACH TO BROKER-DEALER REGISTRATION

Despite the SEC's insistence that four key questions be addressed when establishing whether an individual is acting as a broker-dealer,[57] a review of the no-action letters regarding business brokers reveals that only two of those questions are consistently cited as critical.[58] First, and most importantly, is the role a finder plays in the negotiation process. In the early letters to Corporate Forum and Russell Miller, the SEC adopted a rigid stance that prohibited the business broker from any participation whatsoever in the negotiations between the business buyer and seller.[59] The SEC began to shift its approach with IBEC and CBI by allowing limited participation through the transmission of documents arranged outside of the presence of the business broker.[60] In contrast, Fulham & Co., whose no-action request was denied, actively participated in negotiations and was admittedly akin to an investment bank.[61] Yet in Hallmark Capital, the SEC denied a no-action request even though Hallmark

52. *Id.* at *2.

53. *Id.*

54. *Id.* at *3. Recognizing the SEC's concerns about the collection of commissions, Hallmark Capital explained that it did so "to enable the small company client to afford to retain the services of Hallmark Capital without any obligation to close on a transaction." *Id.*

55. *See id.* at *1.

56. *See id.*

57. *See* DIV. OF TRADING & MKTS., U.S. SEC. & EXCH. COMM'N, *supra* note 14, at pt. II.A.

58. *See* discussion *supra* Part I.

59. *See* Corporate Forum, 1972 WL 9128, at *1–2; Russell Miller, 1977 WL 10938, at *4–5.

60. *See* Country Bus., 2006 WL 3289777, at *1; Int'l Bus. Exch., 1986 WL 67535, at *1–2.

61. Fulham, 1972 WL 9129, at *2.

Capital was to play practically no role in the negotiation process.[62] Thus it cannot be the case that participation in negotiations, or lack thereof, is a dispositive factor that may alone decide whether registration is required.

The second critical question is whether the business broker receives transaction-based compensation in exchange for the services rendered. In a 1985 no-action letter, the SEC stated that "[a]s a general matter, a person that receives a percentage of a commission or transaction-based compensation would be required to register as a broker-dealer."[63] The SEC's reasoning is a product of its desire to keep a close watch on those who have a "salesman's stake" in transactions involving securities.[64] In particular, the SEC is concerned that unregistered brokers may practice high-pressure sales tactics, thereby forcing unwanted or misunderstood securities transactions upon hapless investors.[65] Russell Miller was granted no-action relief where he was to receive transaction-based payment, but vowed to refrain from participating in negotiations altogether, thereby limiting his opportunity to force the consummation of a deal.[66] IBEC and CBI, while both participating, albeit passively, in the negotiation process, were granted no-action requests despite their plans to collect a commission.[67] Yet Hallmark Capital—which was to receive a commission, but was not to participate in negotiations—was denied a very similar request.[68]

What differentiates these two outcomes lies in the safeguards put into place by both CBI and IBEC that are lacking in the Hallmark Capital scenario. In particular, while the CBI/IBEC compensations were transaction-based, they were not *necessarily* linked to the

62. *See* Hallmark Capital, 2007 WL 1879799, at *1–3.

63. John M. McGivney Sec., Inc., SEC No-Action Letter, 1985 WL 54255, at *1 (May 20, 1985).

64. *See* Herbruck, Alder & Co., SEC No-Action Letter, 2002 WL 1290291, at *5–6 (June 4, 2002); *see also* Zambrowicz & Burbach, *supra* note 11, at 5 (comparing the compensation schemes in the IBEC and CBI no-action letters).

65. *See* John L. Orcutt, *Improving the Efficiency of the Angel Finance Market: A Proposal to Expand the Intermediary Role of Finders in the Private Capital Raising Setting*, 37 ARIZ. ST. L.J. 861, 908 (2005) ("The concept is that transaction-based compensation could induce the finder to engage in abusive or sharp selling practices based on her stake in the outcome of the transaction . . . ."). Henry C. Goppelt, despite his sharp-tongued plea, was a finder who both participated in merger negotiations *and* received a transaction-based fee. Goppelt, 1974 WL 10669, at *2. Thus it seems he had both the opportunity (in negotiation) and the motive (transaction-based payment) to engage in abusive sales tactics. *Id.*

66. Russell Miller, 1977 WL 10938, at *4–5.

67. *See* Country Bus., 2006 WL 3289777, at *1; Int'l Bus. Exch., 1986 WL 67535, at *1.

68. *See* Hallmark Capital, 2007 WL 1879799, at *1.

merging parties' decision to utilize cash or securities to effect the transaction.[69] The compensation was determined *before* negotiations between the parties took place.[70] Hallmark Capital, on the other hand, placed no such safeguard upon its compensation.[71] Although the receipt of transaction-based compensation is nearly dispositive, there seems to be room to accept such remuneration as long as the two businesses remain free to choose the form of consideration and the business broker takes no part in negotiating the deal.[72]

III. ESTABLISHING A FORMAL EXEMPTION

Given the SEC's somewhat stable approach to business brokers, and the pressing need of finder services for small businesses, the SEC would be wise to institute a formal exemption from broker-dealer registration for those finders that restrain their activities to those that have been deemed acceptable under the current, informal exception. Such an exemption should be restricted to those business brokers that either (1) receive no transaction-based compensation, or (2) take no part in negotiations between the target and acquirer. For those brokers that choose to receive transaction-based compensation, the safeguards instituted by CBI should be followed. Namely, the decision to receive a commission should be made prior to the consummation of the deal, and should not depend upon the form of consideration chosen to effect the merger. With such safeguards in place, the broker will have neither the incentive nor the opportunity to pressure the negotiating parties into a hasty or ill-conceived transaction. If a business broker is to receive a flat fee, whether hourly or otherwise, it should be allowed to participate in negotiations between the parties. This exemption would provide small businesses with the industry expertise of an experienced finder, but would also prevent high-pressure sales tactics by severing the link

69. *See* Country Bus., 2006 WL 3289777, at *1; Int'l Bus. Exch., 1986 WL 67535, at *1. In the case of IBEC, its compensation would not vary depending upon the form of consideration utilized by the parties. Int'l Bus. Exch., 1986 WL 67535, at *2. For CBI, its compensation would be decided prior to the determination of the form of consideration and would not vary depending upon whether securities or assets were used. Country Bus., 2006 WL 3289777, at *1.

70. *See* Country Bus., 2006 WL 3289777, at *1; Int'l Bus. Exch., 1986 WL 67535, at *1.

71. *See* Hallmark Capital, 2007 WL 1879799, at *1.

72. *Compare* Int'l Bus. Exch., 1986 WL 67535, at *1 (introducing safeguards against high-pressure sales tactics), *and* Country Bus., 2006 WL 3289777, at *1 (expanding safeguards against high-pressure sales tactics), *with* Hallmark Capital, 2007 WL 1879799, at *1 (abandoning any use of safeguards).

between the finder's compensation and the consummation of the deal.[73]

Nor would such an exemption be without precedent. In South Dakota, a finder is not required to register as a broker-dealer under state law if she complies with the statutory limitations upon her ability to participate in negotiations and receive transaction-based compensation.[74] Texas has created a streamlined registration and regulation process for finders willing to limit certain activities; finders in Texas may not, for example, "participate in negotiating any of the terms of an investment."[75] In 2003, the SEC Government-Business Forum on Small Business Capital Formation acknowledged that a new approach to finder regulation was needed to simplify the current regime.[76] The SEC has, in the past, exercised its rulemaking authority to exempt from the definition of "broker" certain employees of the issuer who help place the issuer's securities.[77] The ABA Section of Business Law recently organized a task force on private placement broker-dealers to study what it described as "a major disconnect between the various laws and regulations applicable to securities brokerage activities and the methods and practices actually in daily use by which the vast majority of capital is raised to fund early stage businesses in the United States."[78] The ABA's report is an exhaustive and much-needed source of guidance for finders, but it fails to recommend an outright exemption for business brokers, suggesting instead that a truncated registration and regulation scheme be implemented.[79]

Critics of an outright exemption worry that unscrupulous finders, currently unregistered, would "hide behind the available

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73. The SEC's CBI No-Action Letter appears to recognize the virtues of flat fee structures for business brokers. *See* Zambrowicz & Burbach, *supra* note 11, at 5. When a business broker receives a flat fee, after all, it is "less likely that the business broker will have a 'salesman's stake' " in the transaction. *Id.*

74. S.D. ADMIN. R. 20:08:03:17 (2010).

75. 7 TEX. ADMIN. CODE § 115.11(a)(9) (2010).

76. Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *supra* note 8, at 1014–15.

77. *See* 17 C.F.R. § 240.3a4-1 (2010).

78. Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *supra* note 8, at 959. While the ABA's report focused primarily upon finders engaged in the placement of securities for small businesses, it expressly recognized that its conclusions would be applicable to business brokers as well. *Id.* at 960.

79. *See id.* at 1008 ("Some attorneys have suggested that providing for a registration exemption for a category of financial intermediaries which engage in finder activity on a limited basis (which has not been flushed out with further discussion) is a better alternative than a regulatory/registration scheme of the type we are proposing.").

exemption."[80] According to this argument, at least some minimal level of registration is required to monitor finders and help consumers screen potential business brokers.[81] This approach would fail, however, to provide additional protection. Absent suspicion of fraud, the SEC rarely, if ever, brings an enforcement action against a finder for failure to register alone.[82] More importantly, the broad anti-fraud protections provided by Rule 10b-5 are effective against finders without regard to registration.[83] Nor is registration necessary to protect consumers from unscrupulous finders; Rule 10b-5 carries with it an implicit private right of action.

Others contend that the most recent financial crisis was a product of insufficient financial regulation. Exempting finders would be less regulation at a time when many believe that more regulation is needed. Assuming, arguendo, it was a *lack* of regulation and not merely *poor* regulations that led to the 2008 recession, this argument still misses the mark. The flurry of debate over financial oversight which culminated in the passage of the Dodd-Frank Act was aimed largely at so-called "systemically significant" institutions—investment banks and commercial lenders of such enormity that their existence alone poses risks to the financial stability of the entire nation.[84] The exemption proposed in this piece addresses finders that service businesses with market capitalizations of less than $5,000,000. This may be a large sum of money for any individual, but it hardly qualifies as "systemically significant," and any crooked behavior by an exempt finder could be more than adequately punished by resorting to Rule 10b-5.

Quite to the contrary, the recent financial crisis highlights an acknowledged need to aid the growth and development of American small businesses. Several provisions of the Dodd-Frank Act call on

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80. *Id.* at 1009.

81. *Id.*

82. Michael B. Gray, *Unregistered Finders: The Trap for the Unwary*, NEAL, GERBER & EISENBERG, LLP (Aug. 25, 2009), http://www.ngelaw.com/news/pubs_detail.aspx?ID=1087; *see also* Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *supra* note 8, at 997 ("[T]hese suits rarely deal exclusively with using an unregistered broker-dealer .... The results of the lawsuits are driven primarily ... by the allegations of fraud and misrepresentation.").

83. 17 C.F.R. § 240.10b-5 (2010) ("It shall be unlawful for any person, directly or indirectly ... (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.").

84. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 102(a)(7), 124 Stat. 1376, 1392 (2010) (to be codified at 12 U.S.C. § 5311) (defining "significant institutions").

the SEC to consider the burdens placed upon small businesses before enacting its rules and regulations.[85] President Barack Obama signed into law the Small Business Jobs Act of 2010 in an attempt to "increase the availability of credit for small businesses."[86] Owners of small businesses may find that survival hinges upon a successful merger with a cash-rich partner. The year 2010 stood witness to an uptick in such activity, but the SEC can do more to foster this trend. The proposed exemption for business brokers would reduce confusion among potential finders without diminishing the positive incentives created by transaction-based payments. At the same time, it would provide sufficient protections for small businesses while injecting some much-needed clarity into the " 'gray market' of brokerage activity" upon which "a vast number of small businesses" rely for seed funding and merger consultation.[87]

CONCLUSION

As the banking industry continues to consolidate, small businesses are finding it increasingly difficult to attract and retain much-needed services from registered broker-dealers and investment bankers. The SEC's reluctance to provide concrete, reliable precedent has effectively precluded the development of a legion of business brokers that could competently, and affordably, provide merger consultation. A formal exemption from broker-dealer registration for business brokers would be a small, but invaluable boost for American small business.

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85. *See, e.g.*, *id.* §§ 971(c), 956(f), 952(a)(4), 951(c) (to be codified in scattered sections of 15 U.S.C.). Under Dodd-Frank, the SEC has authority to exempt "small issuers" that would be "disproportionately burden[ed]" by the requirements of the Act. *Id.* § 971(c).

86. Pub. L. No. 111-240, 124 Stat. 2504, 2504 (2010) (to be codified in scattered sections of 15 U.S.C.)

87. Task Force on Private Placement Broker-Dealers, ABA Section of Bus. Law, *supra* note 8, at 959, 960.