

**PERSPECTIVES ON BROKER-DEALERS  
FOR (NON SECURITIES) BUSINESS LAWYERS**

**CAROL BAVOSETT MATTICK, P.C.**  
Corporate and Securities Law  
for Growing Companies

Austin:  
512-328-2278 (T)  
512-532-6554 (F)

San Antonio:  
210-272-1860 (T)  
210-272-1866 (F)

[carol@cbmattick.com](mailto:carol@cbmattick.com)

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**CHAPTER 6**





CAROL BAVOSETT MATTICK, P.C., ATTORNEY AT LAW  
CORPORATE AND SECURITIES LAW FOR GROWING COMPANIES

## CAROL BAVOSETT MATTICK

Carol Mattick graduated in December 1984 with a law degree and MBA simultaneously from University of Texas at Austin. After a four year stint with a large law firm in San Antonio, Texas, she began a solo law practice dedicated solely to providing corporate and securities law advice to growing companies. Her clients and assignments have included acting as part-time in-house counsel for a medical device company; working with venture portfolio and other companies seeking private equity capital; companies developing intellectual property assets and/or engaged in product development with a “license out” business model; representation of “angel” investors; representation of senior executives with respect to employment and incentive compensation packages as they go from pre- IPO to post-IPO and cashing out those incentive packages; representation of private companies being acquired; and all kinds of contract drafting. Her skill sets include a variety of private equity securities offering work, corporate restructuring or re-organization of private companies, Sales of private companies with annual revenues up to \$30 million, licensing agreements and other kinds of business transactions and contracts. Carol has been in solo practice doing this kind of work for twenty plus years.

Although she started her practice in San Antonio, Carol Mattick established a second location in Austin in 1998. The purpose was to take advantage of the large need for corporate legal services in that booming economy. Since then, she has split her time fairly equally between the two cities and between San Antonio and Austin clients. From time to time, she finds herself in a position akin to in-house counsel, bringing together the exact expertise needed by a client and managing the delivery of that expertise.

Ms. Mattick has taught the subjects in which she practices law to MBA level graduate students at UT Austin in the Masters in Science and Technology Commercialization offered by that institution's IC2 Institute. IC2 was founded by George Kozmetsky after his stint as dean of the UT business school and was the original parent organization for the Austin Technology Incubator and the Capital Network.

She has been a member of the planning committee of UT Law's Conference on Securities Regulation and Business Law Problems for many years, has been a speaker at that conference and co-chaired it in 2010; She was a creator and co-chair of the planning committee of UT Law's Private Companies Institute and a speaker at that conference which focuses on companies that intend to remain privately held or only consider acquisition as a retirement or exit option. She has also been featured as a speaker at the State Bar of Texas' courses in Advanced Business Law, the Essentials of Business Law and Representing Small Businesses, making presentations on broker-dealer rule making on the state and federal level and the fundamentals of contract drafting. She has spoken at meetings of the ABA Section on Taxation, Closely Held Businesses committee and the Section on Business Law, State Securities Regulation committee.

Ms. Mattick has been a member of the Securities Law committee of the Business Law Section of the State Bar of Texas for more than a decade and has chaired that committee since 2005. Under Carol's leadership, the Securities Law committee is currently working with state regulators to draft an exemption and registration regime for unregistered financial intermediaries, sometimes known as “finders” or deal consultants. In addition, she has been a member of the Business Law Section's governing council since 2008 and in that role is working on finding and creating content for the Texas Journal of Business Law. She also serves on the advisory group to the Center for Transactional Excellence at South Texas College of Law in Houston. In that role, she advises a program that teaches law students fundamental areas of

business law through courses organized around structuring and completing particular kinds of business transactions or deals. Carol was a founding board member of the San Antonio Technology Accelerator Initiative (“SATAI”) from its founding in 1999 to 2005.

Carol lives in San Antonio with her husband, Steve, and large hound “Bella”. She works in the community with the National Kidney Foundation and the Girl Scouts.

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## Perspectives On Broker-Dealers

*For (Non Securities) Business Lawyers*



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## WHAT IS A “SECURITY” OR INVESTMENT CONTRACT ?

WHETHER AN INSTRUMENT QUALIFIES AS AN “INVESTMENT  
CONTRACT” FOR THE PURPOSES OF THE 1933 SECURITIES ACT :

INVESTMENT OF MONEY DUE TO  
AN EXPECTATION OF PROFITS ARISING FROM  
A COMMON ENTERPRISE  
WHICH DEPENDS SOLELY ON THE EFFORTS OF A PROMOTER OR  
THIRD PARTY

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## When is Equity Needed or Appropriate?

- Bank Loans: Smooth Out Timing Differences
- Bank Loans: Long Term Assets, Transfer Appreciation from LT Assets to Business
- Equity: Start Up, Growth, All Other Circumstances

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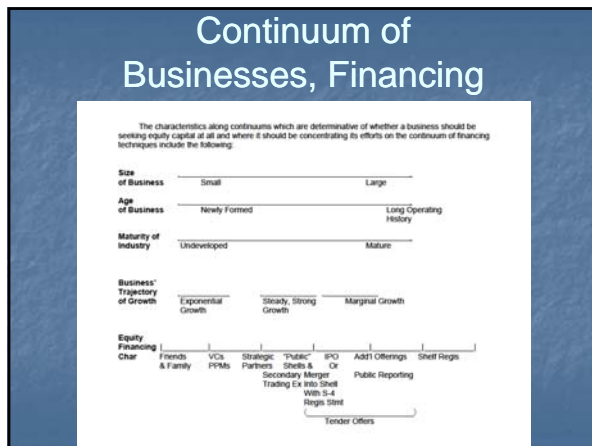
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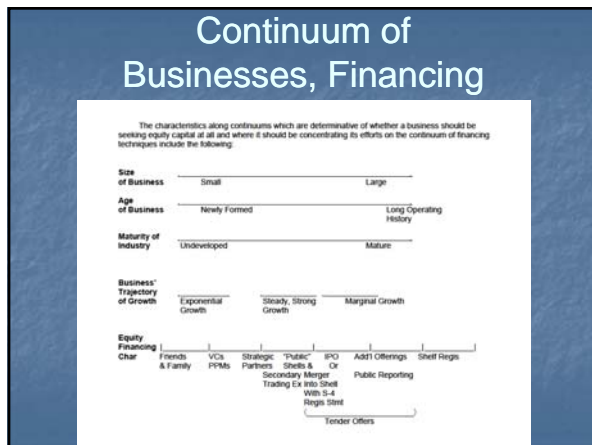
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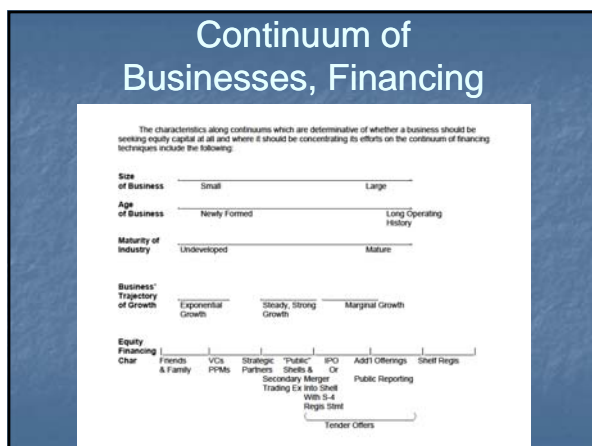
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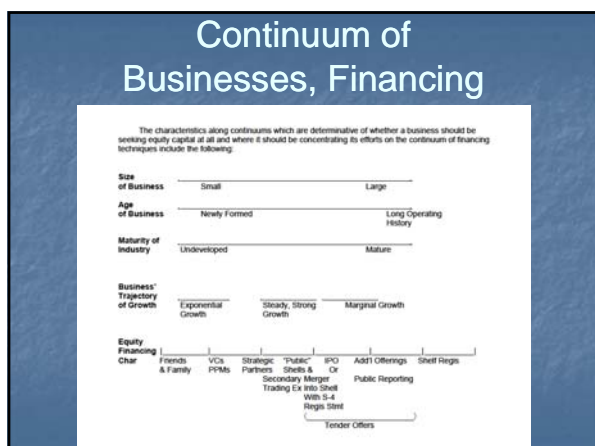
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### An Issuer's Securities Offering *Regulatory Framework and Terminology*

- Registered or public offerings vs Unregistered, but exempt private offerings
- Comply with both Fed and State Laws in states where investors have primary residence
- Notice and fee exemptions vs self executing exemptions

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### Issuer Obligations

- Ensure that investors are sophisticated enough to understand and bear risk of investment
- Provide investors all information necessary to make an informed investment decision a reasonable period of time before invest
- No general solicitation
- Other requirements: some common, some unique to particular states

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### Analysis

- Sale of 100% of the equity interests
- A group comes together to loan money to a business
- Your client buys real estate that someone else will utilize
- An intermediary gathers or sponsors people to invest
- Your client communicates with its current investors on its website

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### A Financial Intermediary

#### *Regulatory Framework and Terminology*

- Two types: Compensation for a finite transaction (Broker/Dealers) vs Compensation for Management of Many Transactions (Investment Advisors)
- Registered vs Unregistered, but Exempt
- Comply with both Fed and State Laws in states where firm resides and investors have primary residence

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### Broker Regulation

- Federal: Sec Exchange Act §3(a)4  
*Any person engaged in the business of effecting transactions in securities for the account of others.*
- State: e.g. Texas Art 581-4.C., E.  
*every person ...who engages in this state ..all or part...time...in selling... securities...  
Every... attempt to dispose of a security for value*

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### Extent of BD Regulation

- Net Capital, Custody and Monthly Reports
- Qualifying Exams for Specific Positions
- Operations: Regulation of Approval of Accounts; How trades are approved; how supervisory systems are implemented; how internal audits and exams are done; how personnel are trained; how complaints are handled
- Recordkeeping: accounts, trading, personnel
- Anti-money laundering, disaster recovery

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### Investment Advisors

- Federal: Advisors Act Section 202 (11)  
*Any person who, for compensation, engages in the business of advising others...as to the advisability of investing in, purchasing, or selling securities ....*
- State: e.g. Texas Art. 581-4.N.  
*a person who, for compensation, engages in the business of advising another... with respect to the advisability of investing in, purchasing, or selling securities, ....as may be further defined by Board rule.*

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### Extent of IA Regulation

- Fiduciary Relation
- Allocation of Trading to Benefit Clients
- Regulation of Advertising to Clients, including Performance Claims
- Adequate Records of Personal Trading and Conflicts;
- Disclosure of referral arrangements and terms of brokerage agreements
- Books and Records; Internal Control Procedures

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### Investment Bankers

- The persons who are putting together IPOs and Acquisitions ;
- May involve the public primary or secondary markets for securities or involve a completely private transaction;
- May involve a securities offering or an asset acquisition.

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### III Fitting Regulation For Private Transactions

- The traditional regulatory scheme for brokers and IA's was formulated with the Public Securities Markets and Public Investors in mind
  - Custody of Funds, Net Capital Requirements
  - Close Regulation of Operations
- But, the law and regulations apply equally to private transactions

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### Long Term Trends

Over the last 25 years, the lessening of Private Issuer regulation has led to...

An Explosion in # of Deals Being Done in Private Transactions, Although Not Across All Kinds of Deals and All Sizes of Issuers

And

An Increase in the Amt of Money Involved in Some of Those Deals

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### Financial Intermediaries Become More Important

- Many More Private Transactions than Public
- Less information readily available about issuers in private transactions means it is more difficult to raise private equity capital
- This difficulty leads smaller issuers and non-venture backed issuers to seek help from financial intermediaries

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### Why is This a Problem?

- Issuer's exemptions sometimes require that any person compensated to help them raise capital must be registered as a broker
- The Proliferation of Private Equity Funds Means There is a Lot of \$\$ Chasing Deals in a Specific Segment and They May Need Help Finding Deals
- From the broker's side, NASD/FINRA Rules Prohibit Sharing Commissions with non-members

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### How Private Transactions Are Different From Public Ones

- Where they involve Accredited Investors and Institutional Investors, the regulation requiring brokers to "know your customer" and determine suitability seem less necessary
- These intermediaries Could Be Working for One Side or the Other or Neither

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### How Private Transactions Are Different Than Public Ones

Brokers in Private Transactions Do Not  
Necessarily Need

- A Connection to Primary Public Securities Markets to Be Effective For Their Clients
- A Connection to Retail or Institutional Client Bases of Traditional Brokers to Be Effective For Their Clients

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### How Private Transactions Are Similar to Public Ones

- They can, but don't necessarily have to, involve Non-Accredited Investors
- The professional brokers or advisers who effect them think of securities offerings and asset acquisitions as two different tools to accomplish similar ends

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### Confusion and Conflicts

- Federal Interpretations - No Action Letters
  - Transaction Based Compensation
  - Negotiation or Advice
  - Solicitation
  - Prior Securities Experience and Violations
  - Consulting Activities
  - Working for Issuers vs Investors vs Investment Banks
  - Dominion Resources, IBEC

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### New Exemptions in Texas

- Adopted in 2005
- TSSB Rules 109.5 and 109.6
- Exemption in TX if Dealer, IA Sells to institutional investors purchasing for their own accounts:

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### Limited Registration Finders in Texas

- TSSB Rule 115.1(a)9. and Rule 115.11
- Application on Form BD, Background Chk
  - Individuals Only
  - Receives Compensation
  - For Introducing to an Issuer
  - Accredited Investors under Reg D
  - For Purpose of Investment
  - In Securities of the Issuer

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### Finders in Texas Prohibitions

- No Involvement in Negotiations of Terms
- No Advice to Any Party Concerning Pros and Cons of Investment
- Cannot do due diligence, valuation or analysis for issuer or investor
- No advertising for Issuers or Investors
- Cannot serve as escrow agent, No custody of funds
- Only Provide Certain Information

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### Finders in Texas Req & Permitted Disclosure

- Must Disclose in Writing to Investors:
  - The Compensation Paid to Finder
  - That Finder Cannot Advise Investor
  - Conflicts of Interest
- May Only Disclose to Investors
  - Contact Info for Issuer, Contact Person
  - Name and Description of Securities
  - Brief (25 Word) Description of Business
  - Type, Number, Aggregate Amt of Securities Offered

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### Texas Response in Progress Limited Regis “Private Equity Dealers”

- The difficult issues arise when intermediaries are doing more for their clients
- The Committee has entertained a first draft of a rule for limited registration of persons more involved in the deal
- No consensus has been reached with the state regulators as of yet

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### Private Equity Dealers Limited Registration

- Application on Form BD, Background Chk
- Individuals and Firms
- Receives Compensation
- For Selling Securities
- Transactions Only With Certain Investors:
  - All Accredited Investors under Reg D
  - Qualified Institutional Buyers under Rule 144A
  - Entities with Net Worth of \$5 Million or More

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### Private Equity Dealers Limited Registration

- Can Negotiate Terms, Advise, Conduct Due Diligence, Valuation and Analysis
- Can Provide Any Info to Investors
- Transactions Not Involving Public Offering
- Cannot serve as escrow agent, No custody of funds

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### Private Equity Dealers Limited Registration

- General Securities Exam
- Supervisory Requirements if Agents
- Same Recordkeeping Requirements as for Finders
- Furnish the Records to TSSB on Request

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### Apply the Current Tools

- The Texas Exemptions From Dealer and Investment Advisor Registration in State
- The TX Limited Registration Finder Rule
- Staying Outside the Fed Definition of Broker “Engaging in the Business” and TX Definition of “Dealer”
- The TX Business Broker Exam Waiver
- Asset Acquisitions vs. Securities Transactions

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### Examples & Analysis

- The Multi-State Angel Investment Deal
- The Consultant with 25 Yrs Experience in the Industry
- Finders for Pvt Equity Firms or Investment Banks
- Michael Dell's Childhood Friend

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### Examples & Analysis

- Two Guys (Formerly from Goldman Sachs) in an Office
- The Merchant Banker
- The CFO Charged with and Getting Incentive Compensation for Raising Capital

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### Investment Companies

#### *Regulatory Framework and Terminology*

- Investors coming together to invest in other securities or investments rather than to invest in an operating business >40%
- Registered vs Unregistered, but Exempt
- Often requires a registered offering in addition to registration as Inv. Co.
- Open End vs Closed End
- Often but not always Advised by Inv Adv

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### Exempt Investment Co's

- Inv Co Act of 1940 ("ICA") §3(c) (1)  
100 or fewer beneficial owners and no public offering
- ICA §3(c)(5)(C) No redeemable securities and Purchasing liens or mortgages on real estate
- ICA §3(c)(7) All equity holders are "Qualified Purchasers" and no public offering

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### Examples & Analysis

- Inadvertent Investment Companies  
Yahoo's investments in small tech
- Hedge Funds and Private Equity Funds
- Real estate and oil & gas investment entities.

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### Examples & Analysis

- Captive funds
- Pick and choose features of registered investment companies to use in exempt investment companies

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### At the End of the Day.....

- Responsibly Encourage Capital Formation In Businesses From \$0 to \$75 M
- Reputable, Effective Ways to Access Equity Capital
- Without Regulatory Barriers That Defeat Our Purpose
- Without Disreputable People Preying on Businesses, Their Investors or Acquirers

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Thank You

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