Nassau Lawyer

SEC No-Action Letter Permits Private M&A Brokers to Avoid Registration as Broker-Dealers

On January 31, 2014 (and later revised on February 4, 2014), the Securities and Exchange Commission issued a no-action letter which clarified circumstances where a private M&A broker would not be required to register as a broker-dealer.[1]

Seth I. Rubin

Prior to the adoption of the SEC's new position, M&A brokers and intermediaries that were involved in soliciting and advertising the sale or acquisition of a business – specifically, when such a transaction involved a stock sale – were required to register with the SEC as broker-dealers.

While the no-action letter provides guidance under only a limited set of circumstances, it is instructive and provides much needed guidance for future private transactions that utilize the services of a private M&A broker.

Background

Section 15(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), prohibits anyone acting as a broker dealer that "make(s) use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless such broker or dealer is registered pursuant to Section 15(b) of the Exchange Act.[2] The term "broker" is defined as "any person engaged in the business of effecting transactions in securities for the account of others.[3] The SEC has typically interpreted this definition broadly, particularly in transactions where a "success fee" arrangement is utilized.[4]

Typically, private M&A brokers are utilized in private transactions by soliciting buyers or sellers for a specific transaction, negotiating on behalf of clients, assisting in structuring a transaction, and assisting in valuing a target company. In addition, some transactions contemplate a success fee which ties the successful closing of the transaction with the payment of the broker's fee.

Ron Ben Bassat

In circumstances where the transactions take the form of a stock sale, such activities and fee structures require that the broker be registered with the SEC as a broker-dealer. (Additionally, state requirements may also apply.) Determining broker activities and fee structure can be particularly troublesome when the parties, at the outset of negotiations, are unsure of how the transaction itself will be structured.

Guidelines Provided by the No-Action Letter

The SEC's no-action letter provides specific guidelines and requirements before an M&A broker may be permitted to facilitate mergers or acquisitions, assist in structuring a transaction and becoming eligible to receive success fee compensation. In addition, the SEC's no action letter only applies to private companies (*i.e.*, a company that does not have a class of securities registered, or required to be registered, with the SEC) that are operational and

See BROKERS, Page 22

BROKERS...

Continued From Page 15

are not deemed to be a "shell company."[5] The SEC's no-action letter includes 10 specific requirements, which set forth when a private M&A broker may operate without registering as a broker-dealer:

1. The M&A broker will not have the ability or authority to bind a party to the proposed transaction.
2. The M&A broker will not directly, or indirectly through an affiliate, provide or arrange for private financing for a transaction.
3. The M&A broker will not have custody, control or possession, and will not handle, funds or securities involved in the transaction.
4. The proposed transaction will not involve a public offering.
5. In the event that an M&A broker represents both a buyer and seller in a transaction, the broker must provide written disclosure of the representation to all parties and obtain written consent from both sides regarding the joint representation.
6. In the event the buyer involved in the transaction is composed of a group, the M&A broker will not assist in forming the buyer group.
7. The buyer, or group of buyers, will, upon completion of the acquisition, control and actively operate the company or the business conducted with the assets of the business.

> Importantly, the SEC's no-action letter contemplates a private transaction where the buyer, or group of buyers, will control and operate the acquired company.

8. The acquired company or business will not be purchased by a passive buyer or group of buyers.
9. The securities received by the buyer or the M&A broker will be restricted securities within the meaning of Rule 144(a)(3) of the Securities Act of 1933, as amended.
10. The M&A broker is not barred from association with a broker-dealer by the SEC, any state or any self-regulatory authority or organization and is not suspended from association with a broker-dealer.[6]

Importantly, the SEC's no-action letter contemplates a private transaction where the buyer, or group of buyers, will control and operate the acquired company.

A buyer or group of buyers would exhibit the necessary control if it has the power, directly or indirectly, to direct the management or policies of a company, whether through ownership, by contract or otherwise. This level of control will be presumed to exist if, after the transaction is consummated, the buyer(s):

(i) has voting control of 25% or more of a class of voting securities;has the power to sell or direct the sale of 25% or more of a class of voting securities; or in the case of a partnership or limited liability company, has the right to receive upon dissolution or has contributed 25% or more of the capital in the company. A buyer, or group of buyers, could actively operate the company through their power to elect executive officers and approve an annual budget or by serving as an executive of the company.[7]

Additionally, the SEC's no-action letter also permits a private M&A broker to advertise a private company for sale, which may include the price, description of business and general location.

Conclusion

While the SEC's no-action letter only references a specific set of circumstances where a private M&A broker could be utilized without the requirement of registering as a broker-dealer, it is a welcome relief to some in an area that has caused much confusion. However, private M&A brokers still need to carefully assess whether their specific circumstances fall under the new SEC guidelines and whether any state restrictions may continue to apply to their circumstances.

Seth I. Rubin is a partner at Ruskin Moscou Faltischek, P.C. in Uniondale, where he is Chair of the firm's Healthcare Finance Practice Group and a member of the Corporate & Securities, Health Law Transactional, Financial Services, Banking & Bankruptcy Departments and Corporate Governance Practice Group.

Ron Ben-Bassat is an associate at Ruskin Moscou Faltischek, PC, where he is a member of the firm's Corporate and Securities Department and the firm's Energy Department.

1. M&A Brokers, SEC No-Action Letter (January 31, 2014).
2. 15 USC § 78o.
3. 15 USC § 78c.
4. Herbruck, Alder & Co., SEC No-Action Letter (June 4, 2002); Mike Bantuveris, SEC No-Action Letter (October 23, 1975); Nemzoff & Co., LLC, SEC No-Action Letter (November 30, 2010).
5. Rule 12b-2 of the Securities Exchange Act defines a shell company as a company that (1) has no or nominal operations; and (2) has (i) no or nominal assets; (ii) assets consisting solely of cash or cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets.
6. M&A Brokers, SEC No-Action Letter (January 31, 2014).
7. *Id.*