Important Regulatory Development in the M&A World

No-Action Letter from SEC Regarding "M&A Broker"

The SEC recently issued a "No Action Letter" which states that an M&A Broker, as defined below, under certain conditions, is not deemed to be a broker-dealer for purposes of registration pursuant to Section 15(b) of the Exchange Act.[1]

Broker-Dealers have to register with the SEC. An unanswered question was whether Investment Bankers or attorneys who help in the mergers & acquisitions world ("M&A Brokers") have to register as Broker-Dealers. The issue arises when the transaction is structured as a stock sale or merger, rather than an asset sale. And, usually, the form of transaction is driven by tax, liability and accounting issues of the principals. A partial answer was recently announced by the SEC, but the announcement leaves unanswered questions.

The issue of the status of an M&A Broker for registration purposes was presented to the SEC by a group of attorneys who facilitate mergers, acquisitions, business sales, and business combinations (collectively, "M&A Transactions") between sellers and buyers of privately-held companies. Of particular concern was whether an attorney who facilitates an M&A Transaction through the sale of securities could fall within the definition of "broker" as defined in Section 3(a)(4) of the Exchange Act which would, in turn, require registration as a broker-dealer pursuant to Section 15(a) of that Act.

The SEC's no-action letter confirmed that M&A Brokers (which was not limited to attorneys, but would include investment bankers) can arrange stock sales or mergers in connection of privately-held companies without registering as broker-dealers, subject to conditions. And, importantly, the no-action letter imposes no conditions on either the type of compensation paid to the M&A Brokers or the size of the privately-held company in the transaction. Therefore, if the M&A Broker and the transaction meets the other requirements, the method and amount of the compensation can be predicated on the size of the transaction.

The no-action letter provides relief from broker-dealer registration to an "M&A Broker" - a person 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

[1] See www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf

operate the company or the business conducted with the assets of the company. A privately-held company must not have any class of securities registered with the SEC and must be operating companies and not "shell" companies.

The "no-action" position is subject to a number of conditions:

- the M&A Broker does not have the ability to bind any party in the transaction;
- the M&A Broker does not directly, or indirectly through any of its affiliates, *provide* financing for the transaction, but may *arrange* financing under certain conditions;
- the M&A Broker does not have custody, control, or possession of or otherwise handle funds or securities issued in the transaction;
- the transaction does not involve a public offering;
- if there is a buyer group, the M&A Broker cannot have helped form that group; and
- the M&A Broker, its officers, directors, and employees have not been barred or suspended from association with a broker-dealer under applicable "bad boy" rules.
- the M&A Transaction must result in a buyer or group of buyers acquiring "control" and actively operating the company purchased.

"Control" is the power, directly or indirectly, to direct the management or policies of a company. "Control" is presumed to exist where the buyer or group of buyers obtains: (i) ownership or the power to direct the ownership of 25% of a class of voting securities; (ii) the right to receive 25% of the proceeds upon dissolution; or (iii) has contributed 25% or more of the capital.

The question that remains unanswered is whether registration is required in any situation that does not meet each of the forgoing conditions. For example, if the M&A Broker helps to bring two buyer groups to the table, will that effort require the M&A Broker to register? If the Buyer's broker receives and holds hand money, will that act alone require the M&A Broker to register? If an M&A Broker is operating under a power of attorney, does the ability to make decisions on behalf of the principal require registration as a broker-dealer?

Nonetheless, the "no-action" letter creates a comfort zone for many professionals working in the M&A world.

The forgoing discussion is not intended to be and should not be relied upon as legal advice. To discuss the specifics of your business and legal needs, please contact us at: steve@cherinlawoffices.com; 412-680-5897. Please do not provide any confidential details regarding your business or legal matters in an email or on a phone message until we speak with you and we form an attorney-client relationship.