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SEC Offers Relief to M&A Brokers

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The Office of the Chief Counsel of the Division of Trading and Markets of the Securities and Exchange Commission recently issued an important “No-Action” Letter providing regulatory relief for participants in certain mergers and acquisitions transactions. The letter permits persons who qualify as “M&A Brokers” to facilitate the sale of private companies without registering with the Commission as a broker-dealer, subject to a number of restrictions. While many questions and considerations remain, the M&A Broker designation has the potential to relieve some of the burdens of registration for advisors specializing in private business combinations.

I. Introduction

On January 31, 2014, the Office of the Chief Counsel of the Division of Trading and Markets of the US Securities and Exchange Commission (“the Commission”) issued a “No-Action” Letter¹ permitting “M&A Brokers,” a term generally defined to mean persons that intermediate the sale of private companies to persons that intend to operate those companies, to effect securities transactions in connection with the transfer of ownership of privately-held companies without registration as a broker-dealer under the terms and conditions described below.

II. The Historic treatment of M&A Brokers: Broker-Dealer Registration

Historically, the Commission has interpreted the terms “broker” and “dealer” in Section 15(a) of the Securities Exchange Act (“the Exchange Act”) to require persons engaged in merger and acquisition activity to register with the Commission. For example, in

¹ SEC No-Action Letter re: M&A Brokers (Jan. 31, 2014). <http://www.sec.gov/divisions/marketreg/mr-noaction/2014/ma-brokers-013114.pdf>.

a 1973 “No-Action” Letter to May-Pac Management Company, Commission Staff stated that “persons who play an integral role in negotiating and effecting mergers or acquisitions that involve transactions in securities” were likely to be deemed either brokers or dealers.² The presence of transaction-based compensation, a key Commission consideration in determining broker-dealer status, made this finding almost certain.³

III. Summary of the Relief

3.1 Summary of the Conditions to the Relief

Under the letter, Commission Staff recognize a new category of person exempt from registration as a broker-dealer: the M&A Broker. Under the new guidance, an M&A Broker may take part in buying or selling privately held companies without registering as a broker-dealer pursuant to Section 15(a) of the Exchange Act.

3.2 What Can an M&A Broker Do?

An M&A Broker may facilitate mergers, acquisitions, business sales, and business combinations between sellers and buyers of privately held companies without regard to the size of the company. The M&A Broker can represent both parties, participate in negotiations, advertise the company for sale, and receive transaction-based compensation. However, the company to be bought or sold must be a “going concern.”⁴ Further, companies that are required to file information with the Commission under Section 15(d), companies with registered securities, and “shell”⁵ companies are not subject to relief. In addition, Commission Staff provided a list of 10 criteria M&A Brokers must meet in order to obtain relief from registration with the Commission:

1. The M&A Broker must not have the ability to bind either party to the M&A transaction.
2. The M&A Broker must not provide financing for the transaction, and if the M&A Broker assists in finding financing, it must disclose any compensation in connection with that role in writing to the client.
3. The M&A Broker must not control securities or funds related to the transaction.
4. The transaction cannot involve a public offering.
5. If the M&A Broker represents both parties, written disclosure and consent must be obtained.
6. An M&A Broker can only facilitate a transaction with multiple buyers if the group was formed without assistance of the M&A Broker.

² May-Pac Management Co., SEC No-Action Letter, 1973 SEC No-Act. LEXIS 1117 (December 20, 1973).

³ In Russell R. Miller & Co., Inc., SEC No-Action Letter, 1977 WL 10938 (Aug. 15, 1977), Commission Staff allowed an intermediary playing only a finder’s (i.e., introductory) role in connection with a transaction to avoid registration as a broker-dealer as long as it “does not play a direct role in the negotiations, does not deal substantively with the other party to the transaction on behalf of the client, and does not receive [transaction-based compensation].”

⁴ In this context, a “going concern” need not be profitable, and could even be emerging from bankruptcy, so long as it has actually been conducting business, including soliciting or effecting business transactions or engaging in research and development activities.

⁵ A “shell” company is a company that: (1) has no or nominal operations; and (2) has: (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets.

7. The buyer must control and actively⁶ operate the company when the transaction is complete.⁷
8. The transaction cannot transfer an interest to a passive buyer.
9. Any securities the M&A Broker or the buyer receive must be restricted securities.
10. The M&A Broker cannot have been suspended or barred from association with a broker-dealer by the Commission, FINRA, or any state regulator.

3.3 What Can't an M&A Broker Do?

In addition to the qualifications above, an M&A Broker may not engage in other activities traditionally associated with a broker-dealer. These include, among other things:

- Participation in private placements (other than M&A transactions, as described);
- Intermediation of secondary market transactions (including private sales of “less than” control stakes);
- Market making;
- Other secondary market trading;
- Securities lending and finance (including advisory);
- Underwriting or other capital leasing;
- Public M&A (M&A transactions involving a public offering); and
- Receipt of other than restricted securities by the M&A Broker.

3.4 Policies and Procedures

In light of the many requirements Commission Staff have set out for M&A Brokers, companies planning on taking advantage of the exemption from registration should establish policies and procedures that are reasonably designed to (a) keep within the guidance and any other legal requirement that may be applicable (e.g., state law), and (b) allow M&A Brokers to demonstrate to applicable authorities that they are within the provided guidance.

IV. Conclusion

Many questions and considerations remain for companies wishing to take advantage of Commission Staff's guidance on M&A Brokers. In particular, how this guidance will play out in respect of various state law regimes requiring registration of brokers, dealers, and salespersons (or sales agents) remains an open question that will, of necessity, be answered on a case-by-case basis. The implications of the M&A Broker designation for anti-money laundering and “know your customer”

⁶ A buyer could actively operate the company through the power to elect executive officers and approve the annual budget or by service as an executive or other executive manager, among other things. It remains unclear what level of involvement must be undertaken by a sponsor, such as a private equity or other purchaser, in order to meet this standard.

⁷ Under the guidance, the necessary control will be presumed to exist if, upon completion of the transaction, the buyer or group of buyers has the right to vote 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.

principles, likewise remains to be seen. However, the M&A Broker designation has the potential to relieve some of the burdens of broker-dealer registration for advisors specializing in facilitating private business combination transactions.

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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