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Mergers and Acquisitions Practice
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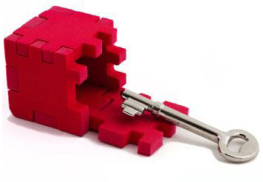

M&A Broker Registration Relief

By: Reginald Champagne, John B. McKnight and Michael K. Renetzky

On January 31, 2014, the staff at the Securities and Exchange Commission (the "SEC") Division of Trading and Markets (the "Staff") issued a no-action letter (the "M&A Broker Letter ")[1] with respect to mergers and acquisitions brokers (each, an "M&A Broker") permitting a person facilitating mergers and acquisitions transactions involving privately-held companies ("M&A Transactions") to receive transaction-based compensation under specific conditions without having to register as a broker-dealer under Section 15(a) of the Securities and Exchange Act of 1934 (the "Exchange Act").

Background

Previously, a distinction was drawn between the sale of a company through an asset transfer, and the sale of a company through a transfer of securities or merger. For the person facilitating the transaction, the asset transfer did not raise broker-dealer registration issues. For the person facilitating a transfer of securities or merger, it was very likely that broker-dealer registration was required. The Staff's previous guidance provided some modest relief for so-called "finders" in M&A Transactions, but there were substantial restrictions on the involvement of the finder in the transaction and transaction-based compensation was generally prohibited. Now, the M&A Broker Letter provides guidance that some M&A Brokers do not need to register as broker-dealers even when they receive transaction-based compensation, and are actively involved in effecting an M&A Transaction involving the transfer of securities or a merger.

Definition of M&A Broker and M&A Transaction

In the M&A Broker Letter, the Staff defines an M&A Broker as 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."

The Staff defines an M&A Transaction by what it may include. That is, a purchase, sale, exchange, issuance, repurchase, or redemption of, or a business combination involving, securities or assets of a privately-held company.

Conditions Required for Relief

To qualify for the relief provided by the M&A Broker letter, several conditions relating to the M&A Transaction must be met. These conditions are summarized as follows:

Privately-held Company Requirement

The business sold must be a privately-held company, meaning that the company "does not have any class of securities registered, or required to be registered, with the SEC under Section 12 of the Exchange Act, or with respect to which the company files, or is required to file, periodic information, documents, or reports under Section 15(d) of the Exchange Act."

No Public Offering

The M&A Transaction must not involve a public offering. This condition essentially brings with it, the body of law and Staff interpretations related to offering of securities under Section 4(1) and Section 4(2) of the Securities Act of 1933.

No Shell Companies

No party to the transaction "will be a shell company, other than a business combination related shell company." A "business combination related shell company" (which would be permitted) would include an entity formed for the purpose of facilitating the transaction, such as a newly created acquisition company subsidiary of the buyer.

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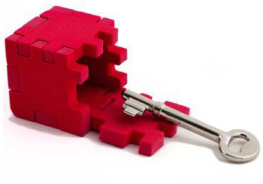

Additionally, the privately-held company that is acquired must be "an operating company that is a going concern and not a 'shell' company."

Buyer's Control and Active Operation of Target

At the conclusion of the M&A Transaction, the buyer must have control of the privately-held company. A buyer has control of a privately-held company "if it has the power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise." Pursuant to the M&A Broker Letter, such control will be presumed to exist if the buyer has (1) the right to vote 25 percent or more of a class of voting securities, (2) has the power to sell or direct the sale of 25 percent or more of a class of voting securities, (3) or in the case of a partnership or limited liability company, has the right to receive upon dissolution or has contributed 25 percent or more of the capital. In addition to having the requisite level of control, the buyer must "actively operate" the privately-held company, which includes, but is not limited to: electing executive officers and approving the annual budget, or serving as an executive or managing officer.

Permitted Services for M&A Brokers in Specified Transactions

In addition to compliance with the conditions for relief described above, the M&A Broker Letters sets forth certain services which are permitted and certain services which are prohibited by the M&A Broker.

In accordance with the M&A Broker Letter, M&A Brokers are permitted to provide the following services in M&A Transactions:

- Advertise the privately-held company;
- Assess the value of any securities sold in the transaction;
- Participate in negotiations for the transaction;
- Represent both buyer and seller with proper disclosure of joint representation and consent from both parties;
- Assist buyers in obtaining financing from unaffiliated third parties; and
- Advise the buyer and seller in the process of issuing securities or otherwise effecting the transfer of the privately-held company.

However, to qualify for the relief provided by the M&A Broker Letter, M&A Brokers must not:

- Have the ability to bind a party to an M&A Transaction;
- Provide financing, directly or indirectly through any of its affiliates, for an M&A Transaction;
- Have custody, control, or possession of funds or securities issued or exchanged at any point of the M&A Transaction; or
- If the privately-held company is purchased by a group of buyers, assist in forming of such buyer group.

Other Considerations

Even if otherwise in compliance with all of the M&A Broker Letter's requirements, M&A Brokers may not rely on the letter if they have been (1) barred from association with a broker-dealer by the SEC or (2) are suspended from association with a broker-dealer.

Finally, the relief only applies to federal broker-dealer registration requirements. M&A Brokers must still consider broker-dealer registration requirements under any applicable state laws. Generally, exemptions are likely to be available under state law. However, these exemptions may require filings or other actions.

1 *A no-action letter represents the position of the Staff that under specified facts the Staff would not bring an enforcement action against the party to whom the letter is issued for violation of the law or rule addressed in the letter. A no-action letter only directly applies to its recipient and does not carry the force of law; however, it is generally recognized that any person acting in accordance with the terms of a no-action letter is operating in a manner that the Staff views as not inconsistent with the law. Therefore, no-action letters are commonly viewed as establishing the guidelines for lawful action and we refer to no-action letters herein as effectively defining the bounds of legal actions.*

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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