PUBLICATION

SEC No-Action Letter Exempts M&A Brokers from Federal Registration Requirements

February 20, 2014

On February 3, 2013, the Security and Exchange Commission's (SEC) Division of Trading and Markets publically issued a significant no-action letter advising that M&A brokers do not need to register as broker-dealers to facilitate mergers, acquisitions, business sales and business combinations. This no-action letter provided important clarification for M&A brokers, defined as persons engaged in the business of effecting securities transactions solely in connection with the transfer of ownership and control of privately-held companies, by deviating from the SEC's long-held view that treated M&A brokers in the same manner as traditional broker-dealers. The letter also paves the way for brokers to withdraw their broker-dealer registration with the SEC if they only represent private companies in M&A transactions.

By way of background, a long-standing issue in the area of broker-dealer regulation concerned the treatment of persons who facilitate the sale of operating businesses. For many years, there was an open question as to whether the sale of such a business was a securities transaction subject to SEC regulation or merely a sale of the assets of the company. In 1985, the Supreme Court definitely answered this long-standing question in *Landreth Timber Co. v. Landreth*, finding that this type of transaction involved a sale of securities. As a result, M&A brokers could be viewed as falling within the SEC's definition of "broker," thereby subjecting M&A brokers to federal broker-dealer registration requirements. Though transactions structured as asset sales did not require registration, it was often uncertain at the beginning of a transaction how the deal would ultimately be structured.

In January 2014, six lawyers submitted a letter to the SEC's Division of Trading and Markets seeking assurances that the Division would not recommend enforcement against unregistered M&A brokers. In doing so, the six lawyers relied on the anomalous results of the existing regulatory structure, in which transactions structured as asset sales did not require registration whereas transactions structured as securities sales did. Among other things, the lawyers observed that transaction structure is generally based on accounting and tax considerations, not the applicability of federal securities laws. Moreover, acquisitions between buyers and sellers of privately-owned companies are qualitatively different than traditional retail or institutional brokerage transactions. For instance, the active role of the buyer and seller distinguishes M&A transactions from retail and institutional brokerage transactions with passive investors. In the February 2014 no-action letter, the SEC granted the requested relief.

In the letter, the SEC sets forth numerous considerations that brokers should consider to determine whether they are exempt from the SEC's registration requirements. The principal considerations articulated by the SEC are as follows:

1. An M&A broker will not have the ability to bind a party to an M&A transaction.
2. An M&A broker will not provide financing for an M&A transaction.
3. An M&A broker may not have custody, control or possession of or otherwise handle funds or securities issued or exchanged in connection with the transaction.
4. The transaction cannot involve a public offering.
5. An M&A broker who represents both buyers and sellers must clearly disclose such representation and obtain written consent from both parties.

6. An M&A broker will facilitate an M&A transaction with a group of buyers only if the group is formed without the assistance of the M&A broker.
7. The buyer must control and actively operate the acquired company.
8. The transaction cannot result in the transfer of interests to a passive buyer.
9. Securities received by the buyer or M&A broker in the transaction must be restricted securities.
10. The M&A broker and its officers, directors and employees cannot have been barred or suspended from association with a registered broker-dealer.

Notably, though the buyer is required to control and actively operate the company, the SEC made clear that the power to elect executive officers, approval of the annual budget and service as an executive officer or manager, among other things, are sufficient to satisfy this requirement. Likewise, control will be presumed to exist if the buyer has the right to vote or dispose of 25 percent or more of a class of voting securities of the acquisition.

In contrast to the majority of SEC no-action letters, the staff's conclusion here is not limited to a particular entity or set of circumstances but rather, provides broad relief to persons who comply with the conditions set forth in the letter.

It should be noted that the letter is limited to the federal registration requirements. Accordingly, the letter does not relieve M&A brokers of possible state regulatory and registration requirements and other applicable state Blue Skies laws. Likewise, a no-action letter does not provide "bulletproof" protection against private actions based on Section 29(b) of the Securities Exchange Act. Accordingly, M&A brokers will need to carefully assess the full spectrum of their legal and regulatory obligations prior to relying on the protections provided by the no-action letter.

Finally, there are important business considerations associated with withdrawing SEC broker-dealer registration. For instance, such withdrawal forecloses an M&A broker's ability to advise public companies with respect to the sale of control.

In summary, while this no-action letter can provide significant relief to M&A brokers from onerous regulatory requirements, M&A brokers should carefully weigh their business interests and the other applicable laws and regulations prior to withdrawing SEC registration.

If you have any questions regarding the SEC's no-action letter or any other related issues, or need assistance in evaluating your company's policies and procedures, please contact an attorney in Baker Donelson's Broker-Dealer/Registered Investment Adviser Group.