DAY PITNEY LLP

alert

February 7, 2014

SEC Grants Relief to M&A Brokers from Broker-Dealer Registration

In a no-action letter dated January 31 and revised on February 4 (the "M&A Brokers Letter"), the Securities and Exchange Commission (SEC) Division of Trading and Markets permitted business brokers to facilitate mergers, acquisitions, business sales and business combinations (collectively, "M&A Transactions") between buyers and sellers of privately held companies without registering as broker-dealers under Section 15(b) of the Securities Exchange Act of 1934 (the "Exchange Act") – even if such transactions are effected through sales of securities. The M&A Brokers Letter brings much-needed clarity to this area of broker-dealer regulation.

Before the issuance of the M&A Brokers Letter, business brokers that effected transactions structured as sales of securities were required to register as broker-dealers, whereas business brokers that effected transactions structured as asset sales (in which there is no distribution, sale or exchange of securities) were not. Many commentators had questioned the validity of this distinction and noted that full-blown broker-dealer registration was not an appropriate regulatory framework considering the limited functions performed by business brokers.

The new relief is limited to business brokers that facilitate sales of privately held companies to buyers that, upon completion of the transaction, will control and actively operate the company. The M&A Brokers Letter stated that a buyer would have the necessary control 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.[1] 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. Only sales of companies that are going concerns and not shell companies will qualify for the no-action relief.

Previously, unregistered business brokers were advised to limit their activities to introducing potential buyers and sellers. Pursuant to the no-action relief, a business broker may now take an active role in facilitating an M&A Transaction without being subject to broker-dealer registration. The business broker may advertise a privately held company for sale with information such as the description of the business, general location and price range. The broker may also advise the parties to issue securities or to effect the transfer of the business by means of securities. Significantly,

Related practice areas:

Broker-Dealers, Investment Advisers and Commodities Firms

Private Equity and Investment Funds

Mergers, Acquisitions and Joint Ventures

For more information, please contact any of the individuals listed below:

R. Scott Beach CT
rsbeach@daypitney.com
(203) 862 7824

Jeffrey A. Clopeck MA
jaclopeck@daypitney.com
(617) 345 4612

Ronald H. Janis NY, NJ
rjanis@daypitney.com
(212) 297 5813
(973) 966 8263

Henry Nelson Massey NJ, NY
hmassey@daypitney.com
(973) 966 8105

Michael T. Rave NJ
mrave@daypitney.com
(973) 966 8123

Michael J. Burwick DC, FL
mburwick@daypitney.com
(617) 345 4637

Eliza Sporn Fromberg NY, NJ
efromberg@daypitney.com
(212) 297 5847

the business broker may participate in the parties' negotiations, provide assistance in obtaining financing from an unaffiliated third party and receive transaction-based compensation, typically viewed by the SEC as a hallmark of broker-dealer activity.

Business brokers seeking to take advantage of the no-action relief are prohibited from (1) having the authority to bind the principals in an M&A Transaction; (2) directly or indirectly providing financing for an M&A Transaction; (3) having custody, control, or possession of or otherwise handling funds or securities issued or exchanged in connection with the transaction; (4) facilitating a transaction with a group of buyers if the group is formed with the assistance of the business broker; and (5) facilitating a transaction resulting in the transfer of interests to a passive buyer. Moreover, the exemptive relief is not available if the business broker or any officer, director or employee of the business broker has been barred from association with a broker-dealer by the SEC, any state, or any self-regulatory organization or is suspended from association with a broker-dealer.

The M&A Transaction may not involve a public offering, and any securities received will be restricted securities. To the extent that the business broker represents both buyers and sellers, it must provide clear written disclosure as to the parties it represents and must obtain from both parties written consent to the joint representation.

Business brokers whose participation in an M&A Transaction qualifies for relief from broker-dealer registration under the Exchange Act, as provided by the M&A Brokers Letter, must still comply with the securities laws of the states in which they transact business. Many states require business brokers that engage in securities transactions to register with the state securities authorities, although several states have limited exemptions for business brokers.

[1] 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 percent or more of a class of voting securities; has the power to sell or direct the sale of 25 percent 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 percent or more of the capital.

Bar Admissions: Connecticut [CT] Florida [FL] Massachusetts [MA] New Jersey [NJ] New York [NY] Washington, DC [DC]