

M&A BROKERS: SEC NO-ACTION RELIEF AND APPLICABLE STATE LAWS

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Introduction - Topics Covered

- **SEC No Action Relief**
- **Factual Examples**
- **State Laws**
- **Proposed NASAA Model Rule**
- **Q&A/Discussion**

SEC No Action Relief

- **Background:**
 - H.R. 2274 passed January 14, 2014.
 - SEC no action letter issued January 31, 2014.
- **Effect:**
 - No action relief for “M&A Brokers” that facilitate the sale of privately-held companies, and receive transaction-based compensation, without registering as broker-dealer under Exchange Act.

SEC No Action Relief - Definitions

- **M&A Broker:**

- Means 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 operate the company or the business conducted with the assets of the company.

- **Privately-Held Company:**

- Means an operating (non-shell) company that 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.

SEC No Action Relief - Services

- **M&A Broker may provide the following services:**
 - Advertise the privately-held company for sale
 - Assess the value of any securities being sold
 - Participate in negotiations for the transaction
 - Advise the buyer and seller to issue securities
 - Most importantly, the M&A Broker can receive transaction-based compensation

SEC No Action Relief - Conditions

- Inability to Bind Parties
- No M&A Broker Financing (but may assist)
- No Handling of Funds or Securities
- No Public Offerings
- Receipt of Restricted Securities
- Disclosures Re: Joint Representation
- No M&A Broker Formed Buyer Groups
- No Shell Companies
- No Barred Individuals

SEC No Action Relief - Conditions

- **Control:**
 - Buyer must “control” the target company.
 - Control exhibited if buyer has power to direct management or policies.
 - Control presumed if buyer, upon completion of transaction: (a) has right to vote or dispose of 25% or more of a class of voting securities of the target; or (b) in the case of a partnership or LLC, has the right to receive upon dissolution, or has contributed, 25% or more of capital.
- **Actively Operate:**
 - The buyer must “actively operate” the target company.
 - Buyer could actively operate the target through (a) the power to elect executive officers and approve the annual budget or (b) by service as an executive or other executive manager, among other things.
 - No other guidance on this condition provided in the letter.

Factual Examples

- **M&A Broker facilitates sale of:**
 - 100% of outstanding securities of private corporation to buyer.
 - 51% of outstanding voting securities of private corporation to buyer.
- **M&A Broker facilitates sale of:**
 - 25% of outstanding voting securities of a private corporation to buyer, and buyer becomes an executive officer (or director).
 - 25% of membership interest in LLC to buyer, and buyer does not become an executive officer or manager.
 - No member controls vote for manager(s).
 - Holder of majority of interests controls vote for manager(s).
- **M&A Broker facilitates sale of:**
 - 25% of outstanding voting securities and buyer becomes an executive officer, but shortly thereafter buyer decides to sell a portion of the securities and resign as an executive officer.

Examples Continued...

- **M&A Broker facilitates sale of:**
 - 100% of outstanding securities to buyer, and intends to split compensation with a party that is not a registered broker-dealer and does not qualify for registration exemption as an M&A Broker.
- **M&A Broker is an affiliate of a private fund manager, and receives transaction-based compensation, in connection with portfolio acquisitions.**

State Laws

- In Oregon, the definition of “broker-dealer” does not include a person effecting sales in connection with a transaction exempt under the Oregon Securities Law. *See* ORS 59.015(1)(d). It may be possible to structure a transaction to comply with:
 - ORS 59.035(2), which exempts an isolated nonissuer transaction
 - ORS 59.035(5), which exempts any transaction with an “accredited investor,” but only if no public advertising or general solicitation
 - ORS 59.035(12), relating to limited sales in Oregon, likely will not work for M&A Brokers because it is conditioned on no commission or remuneration
- In Washington, brokers are also generally exempt from registration if effecting exempt transactions. *See* RCW 21.20.320. It may be possible to structure a transaction to comply with:
 - RCW 21.20.320(1), which exempts sales not involving a public offering. However, this exemption may only be available to sales by target company

Proposed NASAA Model Rule

- This month NASAA requested comment on a proposed uniform state model rule regarding the exemption of M&A Brokers pursuant to state securities laws.
- Comments are due by February 16, 2015.
- Key differences between proposed rule and SEC letter:
 - exemption limited to companies with earnings of less than \$25 million and revenues of less than \$250 million
 - presumption of control measured using a 20% threshold

Q&A/Discussion

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