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Law Alert

To: Firm Clients and Contacts

From: Niesar & Vestal LLP

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Re: **SEC no-action letter establishes exemption from the broker-dealer registration requirements for private company M&A brokers**

Introduction

The SEC recently issued a no-action letter that permits M&A brokers arranging the sale of private businesses to avoid registration with the SEC as broker-dealers under certain circumstances. However business brokers should understand that the no-action letter applies only in specific, limited circumstances and that applicable state securities laws still need to be observed.

No-Action Relief

The SEC issued a no-action letter on January 31, 2014 (subsequently revised on February 4, 2014) that permits certain M&A advisors and business brokers that facilitate mergers, acquisitions, business sales and business combinations between sellers and buyers of privately held companies to avoid registration as brokers-dealers under Section 15(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Broker-dealer registration is a lengthy and expensive process that subjects brokers to significant rules and regulations.

Historically the SEC adhered to a strict view that M&A advisors or business brokers could avoid registration as broker-dealers only if they conducted their business in such a manner that they did not effect transactions in securities in connection with the sale of private companies.

The no-action letter operates as an exemption from registration for M&A brokers that effect transactions in securities in connection with the purchases or sales of businesses. It would permit M&A brokers to advertise privately held companies for sale, advise their clients on

structuring the transaction, provide valuation advice as to the securities being sold in the transaction and receive transaction based compensation, all without registering as a broker-dealer. However the no-action letter does not exempt finders who introduce passive investors in connection with securities offerings. The no-action letter also does not cover the facilitation of sales, mergers or acquisitions of publicly held operating or shell companies, which activities still require broker-dealer registrations.

Eligibility Criteria

The no-action letter only applies if certain criteria are met. Those criteria are as follows:

- The broker cannot have the ability to bind a party to the transaction.
- The broker cannot, directly or indirectly through affiliates, provide financing for the transaction.
- The broker cannot have custody or control of, or otherwise handle, funds or securities issued in connection with the transaction.
- The transaction cannot involve a public offering or a shell company.
- If representing both buyers and sellers, the broker must disclose who it represents and obtain consent from both parties to joint representation.
- If the transaction involves a group of buyers, the group must have been formed without the involvement of the broker.
- The buyer must control and actively operate the company or the business. Control will be presumed if the buyer, or buyer group, 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% of 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. Although the wording of the no-action letter refers to "25% or more of a class of voting securities", we believe the SEC actually meant "25% or more of the voting power of all classes of securities".
- The transaction cannot involve transfers of interests to "passive" buyers.
- Any securities issued in the transaction must be restricted securities as defined in Rule 144.
- The broker must not have been barred or suspended from associating with a broker-dealer by the SEC or any self-regulatory organization.

Any reliance on the no-action letter should involve a careful review of the above restrictions to ensure that a particular broker's activities fall within the confines of the permitted activities.

State Securities Laws

M&A brokers need to be aware that the no-action letter has no effect on state securities laws, most of which also have broker-dealer registration requirements. Many states are likely to continue to take the position that M&A brokers are subject to their regulatory regimes notwithstanding the SEC's revised position at the federal level.

California Law – "Business Opportunity" Broker

California has a unique regulatory structure for persons selling a "business opportunity", as discussed in our Law Alert dated August 23, 2012 on "Sale of Business Transactions in California: What License is Required for an Intermediary?" Most of the people based in California who are covered by the no-action letter would be required to have a Real Estate License unless they are registered as a securities broker in California.

This article is intended to provide a general summary and should not be construed as a legal opinion nor a complete legal analysis of the subject matter. If you would like to speak with a Niesar & Vestal attorney about any matter discussed in this law alert, please contact Gerald Niesar (gniesar@nvlawllp.com), Oscar Escobar (oescober@nvlawllp.com) or June Lin (jlin@nvlawllp.com).